DOCUMENT RESUME

ED 309 298 CE 052 944

AUTHOR DeRand, John
TITLE Developing an Entrepreneurial Enterprise.
INSTITUTION Wisconsin Univ.-Stout, Menomonie. Stout Vocational Rehabilitation Inst.
REPORT NO ISBN-0-916671-90-9
PUB DATE 89
NOTE 77p.
AVAILABLE FROM Materials Development Center, Stout Vocational Rehabilitation Institute, University of Wisconsin-Stout, Menomonie, WI 54751.
PUB TYPE Guides - Non-Classroom Use (055)

EDRS PRICE MF01/PC04 Plus Postage.
DESCRIPTORS *Business Administration; *Business Education; Delivery Systems; *Entrepreneurship; Nonprofit Organizations; *Small Businesses; *Social Services

ABSTRACT

This document explains how to take an entrepreneurial approach to the delivery of a social service. Chapter 1 defines relevant terms, including entrepreneur, profit, social service, and management and also discusses the nature of "value" and the changing public perceptions on the use of public funds. Chapter 2 offers guidance on how to select either a for-profit or not-for-profit organizational approach, write a mission statement, and use a corporation issues chart. Chapter 3 (and the rest of the document) assumes that the entrepreneurial approach was chosen and includes a checklist that covers 66 elements over 8 principal areas (accounting, budgeting and expense control, cash management, credit management, inventory control and management, purchasing, plant and equipment, and pricing) that will affect the ability of the manager to control costs of the enterprise. Chapter 4 describes how to establish a for-profit corporate entity and how to operationalize it. A start-up checklist, a hypothetical schedule, and job aids are included. Chapter 5 explains the application of basic human principles to entrepreneurial enterprises. The appendices contain the following job aids; a Value/Demand Chart; a Selection Issues Chart; a Stakeholder Input/Responsibility Chart; an Implementation Planning Sheet; and a Needs Assessment Worksheet. (CML)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED309298

DEVELOPING AN ENTREPRENEURIAL ENTERPRISE

John DuRand, President
Minnesota Diversified Industries

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

☑ This document has been reproduced as received from the person or organization originating it.

☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL HAS BEEN GRANTED BY

R Fry

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

MDC
Materials Development Center
Stout Vocational Rehabilitation Institute
School of Education and Human Services
University of Wisconsin-Stout

CE052944

DEVELOPING AN ENTREPRENEURIAL ENTERPRISE

John DuRand

President
Minnesota Diversified Industries

Edited By Christopher A. Smith

Copyright © 1989

Materials Development Center
Stout Vocational Rehabilitation Institute
University of Wisconsin-Stout
Menomonie, Wisconsin 54751

All rights reserved. No part of this book may be reproduced or utilized in any form or by any means, electronic or mechanical, including photocopying or recording, or by any information storage or retrieval system without permission in writing from the publisher.

ISBN: 0-916671-90-9

PREFACE

To describe "entrepreneurial" efforts in a "model" format would reduce those efforts to less than their ultimate potential. Any effort to define such a model using specific dimensions will fail to convey the freedom needed to truly be entrepreneurial. True entrepreneurial efforts defy any model constraints because entrepreneurship is a concept, or perhaps an approach, to establishing an enterprise.

The text that follows, therefore, simply provides readers with a general framework upon which unique entrepreneurial efforts may be built. For illustration, the text provides a discussion regarding the development of Corporation X, (now known as MN. P.A.C.) a company that is wholly owned by Minnesota Diversified Industries (MDI). MDI undertook the development of the Corporation X enterprise using an entrepreneurial approach. The approach that was used should be closely examined; the resulting corporation, however, should not be viewed as the model corporation. It is, in fact, only one of a multitude of possible corporate structures that could have resulted from the application of the entrepreneurial concept.

The focus of this document will be on the humanistic potential of business, not on serving individuals with handicaps. Many problems in our present service delivery systems may exist because our focus has been limited to serving individuals with handicaps. This focus has limited our thinking about corporate structure to the recycling of very narrow, traditional delivery systems.

CONTENTS

I. Preface iii
II. Foreword vii
III. Chapter One: Defining the Entrepreneurial Concept 1
A. Definitions 1
B. Profit 1
C. Value 3
D. The use of public funds and changes in public perceptions 4

IV. Chapter Two: Selecting an Organizational Approach 7
A. Does approach selection really make a difference? 7
1. The role of values and prejudices in approach selection 7
2. Cost 9
B. Approach advantages and disadvantages 10
1. Influence of service type 10
2. The ability to selectively switch model structures 11
C. Making the Approach decision 12
1. Writing a mission statement
2. Constructing an issues consideration chart 12

V. Chapter Three: Planning and Implementing the Entrepreneurial Concept 15
A. Building or burning bridges 15
B. Organizing the decision-making process 15
C. An entrepreneurial approach to goal setting 16
D. A discussion of stakeholders 17
E. Fiscal planning 19
1. Concepts and terms 19
2. Developing a lending relationship 22
3. Fixed versus variable cost 23
4. Determining capital required 24
F. Monitoring the operations 25
1. Managing finances 27
2. Sixty-six elements that need consideration 27
G. The implementation detail plan 27

VI. Chapter Four: Planning and Operationalizing Corporation X 37
A. Establishing a corporate enterprise using an entrepreneurial approach: an example 37
B. Deciding to change 38
C. Organizing an implementation plan task force 39
1. The need for employer-sponsored benefits 40
2. The need for full-time employment to increase earning power 40
3. The need for additional vocational opportunities 40
4. The need to improve opportunities to model and interact with non-handicapped coworkers 40
5. The need to provide the opportunity for social interaction 41
6. The effect on trainers 41
7. The need for cost containment 41

D. Factors to be studied and incorporated in operational plan 41
E. Implementation plan and schedule 44
F. Employee stock ownership plan (ESOP) 54
1. Phantom stock 55
2. Ownership as an approach focus 55
a. Ownership in employment 55
b. Ownership in housing 55
c. Ownership in education 56
3. The role of work in ownership 56
4. Elements of ownership 56
G. Governance 58
1. Administrative functions 59
H. Distribution of earnings 59
I. Employee bonus plan 61
J. Financing Corporation X 62

VII. Chapter Five: Applying Basic Human Principles to Entrepreneurial Enterprises 65
A. Corporate accountability 65
1. Responsibility 65
2. Opportunity 65
3. Dignity of risk 66
B. Perceptions/expectations 66
C. Valued activity 67
D. Risk management and the entrepreneur 67

VIII. Appendices 69
A. Value/Demand Chart 69
B. Selection Issues Chart 70
C. Stakeholders Input/Responsibility Chart 71
D. Implementation Planning Sheet 72
E. Needs Assessment Worksheet 73

FOREWORD

In the following examination of an alternative model for the delivery of social services it will be necessary to address concepts such as: profit making, profit generated by the provider of social services, and profit taken from a social service system that is under-funded. They need to be addressed because it is impossible to discuss the entrepreneurial model without discussing and understanding the concept of profit. The manuscript that follows is primarily directed at two audiences—those who are considering the use of an entrepreneurial approach to the delivery of a needed social service, and those who wish to understand individuals who have chosen to use such an entrepreneurial approach.

I request that you, the reader, maintain an open mind regarding the value of the for-profit and the nonprofit model. Although I will attempt to develop a case for the expanded use of the entrepreneurial/for-profit model in the delivery of social services, I will try to accomplish this end without excluding the nonprofit model as a viable delivery vehicle. I strongly encourage you to carefully study the implications of the two alternatives and think through the objectives of the enterprise before an implementation model is selected.

I do not believe that there is strong enough evidence to support a finding that either the for-profit or the not-for-profit approaches to service delivery are singularly capable of delivering quality social services. Nor do I believe that either approach has disadvantages or liabilities that would prohibit it from delivering quality social services.

When all the information that is presented has been reviewed, I feel confident that you will find that the factor driving the choice between for-profit and not-for-profit models is the philosophy of the developer or creator of the required social service. After an approach has been chosen, however, the choice will influence all other decisions that are made. Although many things will be done in a similar manner in each approach, they may be performed for different reasons and result in different outcomes. Therefore, they should be judged independent of one another.

John DuRand

CHAPTER ONE

DEFINING THE ENTREPRENEURIAL CONCEPT

Fundamental to this examination and review is the understanding of some basic terms. Their definitions, provided below, reflect the acceptance that their common use in current literature provides. Key definitions of basic terms are taken from Webster's New Collegiate Dictionary. For example:

Entrepreneur is defined as "one who organizes, manages, and assumes the risk of a business or enterprise."

Profit is defined as "the excess of return over expenditure in a transaction or a series of transactions. The compensation accruing to entrepreneurs for the assumption of risk of business enterprise as distinguished from wages or rent."

By accepting these sample definitions it should be evident that an administrator need not operate a for-profit business to be an entrepreneur. However, it is more common for an entrepreneur to be compensated out of profits rather than wages or rent.

It is also necessary for the reader to understand that resistance is often found to the use of some terms (notably "entrepreneur" and "profit") when used in the context of discussions regarding the delivery of "social" services. The reasons for resistance may shed light on the underlying philosophical base historically developed around not-for-profit organizations.

Definitions

In this manuscript the following definitions will be used to facilitate the understanding of the terms by which they are represented:

1. Service will mean all activities of any enterprise entered into where a provider receives something of value. This includes banking, operating a bakery, making boxes, or building houses. It also includes educating, providing medical care or legal support, and street cleaning within the definition of service. The people who build my house serve me just as my real estate agents serve me when they sell it.

2. The term social service will, however, be used when describing those things that are traditionally (all or in part) delivered by society to the end user. For example: public housing, welfare assistance, rehabilitation services, counseling, and many more.

3. An entrepreneur is a person who can identify the source of required resources and accept the responsibility for directing the vision and activity of the enterprise.

4. Management is the organ of leadership, direction, and decision-making in an enterprise whether it be a social institution or business.

Profit

When I was approached to write this manuscript, the task assigned was to write about an entrepreneurial approach as a model, in the same way I had written about the nonprofit corporation delivering employment services through an industrial business model. That text, The Affirmative Industry, was written within the traditional mind-set where the

structure would automatically be a nonprofit corporation. When I now think back to that time, I did not intend to restrict the implementation of the model from generating profit.

My real intent at that time was to design and describe a not-for-profit model. I believe that model to be different from a nonprofit model. Howard L. Oleck in the fourth edition of Nonprofit Corporations, Organizations and Associations states:

"Right after adoption of the radical New York Statute in 1970, a Practicing Law Institute seminar suggested the idea that non-profit and not-for-profit have different meanings. But this mystical semantic distinction evaporates on close inspection."

For the purpose of this manuscript, therefore, I will ask you (the reader) to accept the idea that not-for-profit entities are not restricted to operating without a profit.

If you take a moment to think about any enterprise operating without a margin of profit, you will find yourself thinking about an entity that is in a critical state—in the process of going out of business. Every business must generate a profit. Even if the investors have no need for a return on investment, the business must generate surplus capital to invest in the future of the company. This investment may be in the form of employee training, updating plant and equipment, research, and/or marketing. If this is not the practice (generating surplus capital) of the organization in which you work, be forewarned that your operation has started the inevitable process of going out of business.

Profit is a term used to describe not one, but many surplus capital scenarios. Incorrectly, profit is believed by some to be incompatible with the provision of human services, even leading to a lack of benefit to society. The term "profit" with or without its modifiers should not be judged until its definitions are clearly understood. On page two, for example, are five uses of the term profit with common modifiers:

Normal profit margin

High profit margin

Low profit margin

Excessive profit

Required profit

Let's take a closer look at the definition of "normal profit margin." Profit never is generated, nor may it be represented, as a single point on a scale (as always equaling 7% or 10%, for example). Instead, profit exists as a continuum.

Two examples may illustrate this point. On one hand, normal profit in the illegal drug industry might be 500 percent at every entry level. This profit potential seems high in relation to other profit levels, but it exists because of the exceptionally high level of risk. On the other hand, the normal profit margin for home builders might be 10 percent on a house built on speculation, 5 percent on a "built-for-owner" home. The normal profit margin is higher on a "spec" house because the risk of substantial interest cost accumulating during the selling process is quite certain. In the first case it is easy to see the correlation between high risk and high profit requirement. In the second case a higher expected possible cost due to interest payments on the construction loan during the selling period is driving the higher required profit margin.

Another set of circumstances that generate a need for high profit is illustrated by the marketing of legal new drugs. Due to the necessity of extended research and testing before FDA approval, the drug must be sold at a high price to generate profit that will restore drained cash reserves. Thus, the high costs for one new drug help to generate a new cash reserve to support the development of another new drug. In addition, some of the "excess" profit is retained in reserve as a protection (both for the company and the public) against possible future lawsuits that might develop based on

unanticipated difficulties experienced by users of the new drug.

Profit, therefore, is not inherently good or bad, nor is there a fixed formula that can be used to generate a "normal" profit margin. Profit is necessary, as reinvestment to protect the future of the organization.

Value

Another issue that needs to be examined involves the question of societal value. Society tends to place a higher value on products and/or services that are produced by not-for-profit corporations than those that are produced by for-profit corporations. However, is there any real evidence that products and/or services provided by a for-profit or entrepreneurial entities are less humanistic than those provided by not-for-profit entities?

Too often, unfortunately, the belief that a profit motive breeds abuse prevails in some segments of society. This attitude is not altogether unfounded. We often read about such cases. What we often fail to recognize, however, is that abuses are perpetrated by not-for-profit providers as well. In addition, there is generally an omission (by the press) to publicize the humanistic trends exhibited by for-profit firms. For example, the sound business practices of a proprietary operation, such as the Andersen Window Company of Bayport, Minnesota, are often un-examined. (Andersen distributes its substantial yearly corporate profit to its workers under a profit-sharing plan that provides benefit rewards to all employees - at every level of the organization. Thus, the company recognizes in a substantive way the contributions of every worker to the production of profit.)

There are many social inequalities in our present institutional system. Have you ever wondered why most hospitals are built with charitable or tax dollars and why nearly all factories are built with commercially borrowed funds or individual and/or collective wealth? After all, a hospital is the place of work for doctors just as a factory is the place of work for machinists.

Generally, the explanation espoused is that hospitals are built to care for people. But wait. Aren't hospitals also the place where doctors generate personal wealth to support themselves and their families? Although a factory is built to make things to be sold, isn't its purpose also to generate the owners' personal wealth to support themselves and their families? I believe that the end result of either organization's operation is the same. Both doctors and factory owners use the facility to make money. The difference in their ability to make money hinges solely on the specific jobs that they perform, and has no bearing on the organization's structure. Doctors care for anyone who can pay the cost of cure and factory owners sell to anyone who can pay the cost of production. Thus, I believe that the only real difference between the operations of not-for-profit and profit-making organizations is a societal perception. One organization, the hospital, is perceived to be involved in a humanitarian activity and the other is not. Thus, the difference relies solely on a societal judgement. I submit that societal judgments, in this as well as many other situations, is blurred.

For example, doctors are providing care and manufacturers are making the drugs and instruments used in the treatment. Are doctors working to benefit the individual or themselves? Could both doctors and manufacturers really be motivated by two desires—wealth accumulation and service to mankind? If so, there is no reason why the medical needs of society can be better met by either the for-profit or the not-for-profit industry. The quality of care will be determined by the individual's ethics and how well resources are applied to serve humanity, not whether there is a profit or no-profit motive in the delivery system.

Because an institution or an entity is staffed by a religious organization or a unit of government does not guarantee that the decisions and judgments made will have an ethical base. There are too many examples of employees of religious organizations and units of government operating in ways totally void of any ethical base. In our culture we often hold a vision of a care-giver of humanity as a selfless, holy, kind and caring person who, in all cases, puts love of mankind ahead of personal goals. We hold this vision even though there are adequate examples of physicians in world history that were wealthy and of elevated social status. These physicians were not judged to be uncaring because they charged a fee for their services or because they lived in the highest social status.

The Use of Public Funds and Changes in Public Perceptions

In 1980 when the Chrysler Corporation asked for financial assistance to preserve a place of work for auto workers (through public financing of a loan program) there was a loud public outcry. Why, said many, should public funds be used to assist private business? I believe that if one of the for-profit hospital corporations of America ran into financial difficulty a "bail out" or loan program would get as much negative press and feedback as Lee Iacocca did at Chrysler.

The "value" review above demonstrates that it is not the activity nor the outcome (i.e., the accumulation of wealth or social status) that leads to a public perception that an organization is operating for profit or not for profit. What makes the difference in this perception is simply the organization's structure as a for-profit or a not-for-profit entity. Only the organized structure generates a definitive opinion regarding whether the organization should receive public support or not.

However, I also believe that there are many examples of individuals employed by not-for- profit organizations accumulating wealth and social status faster than owners and managers of for-profit corporations. Granted, this is not generally the case. However, it does demonstrate that your public persona is more dependent upon how you have structured the operation of your business (what you call yourself), than upon the result (amount of wealth) your employment generates.

Our society encourages citizens to believe that private ownership reduces or eliminates the desire to deliver a social service or to produce products of excellent value. We have developed a societal mind-set that espouses the belief that services delivered by for-profit organizations will always be of reduced quality, thus improving the profits generated for the sole benefit of the owner.

The first major break in this seemingly illogical public perspective came in the field of education. In our nation's early history, public education and church- supported schools were the major organized bodies providing services through educational systems. However, the several existing smaller providers of eduction (that were privately owned but non-profit in nature) were also perceived by the public as being capable of delivering quality education. Until the end of the World War II any attempt to provide educational services to the public by an entrepreneur or a for- profit corporation met with major public resistance. This resistance was based on the premise that knowledge is universal and teaching is sacred. To make money sharing knowledge or teaching would be an offense against society.

The breakthrough for profit-making educational institutions came at the end of World War II. Congress made it possible for returning vets be "entitled" with educational benefits for their service. The numbers of vets desiring these benefits overwhelmed the ability of established schools, colleges, and universities to provide them. (In addition many G.I.s wanted to study subjects and pursue careers that were, at that time, considered to be inappropriate for study in traditional educational institutions.)

Educational entrepreneurs recognized the market demand for educational services and its potential for creating profits. They quickly moved to fill the void by organizing private trade schools, business schools, correspondence schools, and other educational delivery systems. Their motive, in most cases, was to meet a demand in the marketplace and thereby acquire wealth. Most of these schools were legitimate educational enterprises. Unfortunately, some of the "schools" were get-rich-quick schemes organized by people with no society-valued ethical standards. These few unethical entrepreneurs gave all of the for-profit schools a bad name. They remained suspect until a real secondary factor was established by the federal government.

The federal government did not tolerate being ripped off. The taxpayers, as well as the G.I.'s, were being swindled when the unethical profit-making schools failed to provide educational benefits. The government's solution was to provide and demand accreditation of all educational providers who wished to receive G.I. payments. This, in effect, assured that schools met standards determined by various state governments. For the first time a nationwide governmental accreditation of private, for-profit educational facilities was put into effect.

Shortly after accreditation was established, a common belief arose that accredited private, for-profit schools (with monitoring by government to assure standards compliance) could be trusted to deliver quality educational programs.

At the same time, however, thousands of non-profit elementary schools (most of which were sponsored by churches) continued to operate without accreditation using uncertified staff. They simply could not receive payment in G.I. bill dollars. This once again demonstrates that dual standards persist where the for-profit community meets the not-for-profit community.

This discussion is not intended to discourage readers with an interest in providing employment to individuals who are disabled from using an entrepreneurial approach. It has been provided only to familiarize you with the basic social values with which you must contend. If your goal were to develop and operate prisons, there would be far less concern from a societal point of view. Society places a lower value on prisoners. Prisoners are judged able to care for themselves in almost any situation. But if you plan to provide services to people with disabling conditions, you must contend with a public perception that these people need protection against opportunistic providers who have a profit motive; the profit motive is judged to be incompatible with social justice.

There is another social phenomenon of which you should be aware as you begin to formulate your plans. If I were to open a hardware store in a community where I am unknown, and I publicly announce that I am opening the store to accumulate wealth so that my family can live better than anyone else in that community; people would say I am a good businessman with meaningful goals. If I were to add to the statement I will hire two or three employees who are disabled, I would also be judged as a socially responsible person and would be looked up to in the community (until such a time as I had proven otherwise.)

In the same community, however, if I announced that I was going to start a hardware business to employ disabled workers and operate it as a for-profit business to earn enough for my family to live better than anyone else in that community, I would be judged guilty of usury and probably run out of town. The inconsistency of social judgment that surfaces is so subtle that making the employment of persons who are disabled either a primary mission or a secondary mission will determine how the community will judge me.

CHAPTER TWO

SELECTING AN ORGANIZATIONAL APPROACH

No set formula nor fixed set of rules can be relied upon to provide assurance that the best approach to organizational development is selected for a specific set of circumstances. There are, however, a number of fundamental issues that must be considered when a choice must be made between the selection of a for-profit or a not-for-profit approach. The issues that must be considered include:

1. Will values and social prejudices play a role in the approach selection?
2. Will one approach have advantages or disadvantages from the point of view of the service recipient?
3. Will one approach have advantages or disadvantages from the point of view of the management of the service?
4. Will the type of service that is to be provided influence the approach selected?
5. Will a plan for transition (either from a for-profit to a not-for-profit or from a not-for-profit to a for-profit) be appropriate and legal?

Does Approach Selection Really Make a Difference?

I believe that the approach selected will impact management more than it will the general public or the recipient of the service provided.

To quote from Peter Drucker's book, Management, where he describes the function of management:

> "(Management) has to organize work for productivity, it has to lead the worker toward productivity and achievement. It is responsible for the social impact of its enterprise. Above all, it is responsible for producing the results—whether economic performance, student learning, or patient care—for the sake of which each institution exists."

When speaking of management in this context, Drucker does not limit his comments to a single entrepreneur, a board of directors (where membership consists of both outside and inside members), a group of workers in a cooperative, or two individuals wishing to operate as a partnership. Therefore, in this context, when I say selection of approach will effect management more than anything else, I am speaking of management as a function not as a structure.

The role of values and prejudices in approach selection

Drucker also stated that "(management) is responsible for social impact" during a discussion of management responsibilities. He implied in this statement that every organization, whether organized as a for-profit or a not-for-profit entity, is responsible for the social impact it causes and its operational activities. This is important because, although popular opinion assumes that not-for-profit organizations are more ethical than for-profit organizations, this is not borne out by facts. Quite the contrary; you can find examples of unethical practices in both the for-profit and the not-for-profit sectors.

Because effective managers will strive to meet their specific target objectives even though they have limited resources, it is important to know which elements of the choice between for-profit and not-for-profit approaches will have the greatest influence on the allocation of resources.

Earlier, I pointed out that every organizational entity must produce income greater than expenses. I chose to call the excess income profit (although the more faint of heart involved in the delivery of social service may call the excess earnings or contribution to fund balance.) The ultimate use of these profits is the principal deciding factor governing the establishment of not-for-profit or for-profit enterprises. There are many legitimate activities to which profit may be allocated by organizations. These allocation areas include:

1. Research and development
2. Capital reserve funds
3. Training and development of workers
4. Return to investors
5. Charitable giving
6. Employee bonus plans
7. Management bonuses

None of the above allocations are negative until they are implemented in an excessive way. Excessiveness must be valued on both the positive and negative side. For example:

1. The reinvestment of profits in capital equipment is an acceptable allocation. In fact, the failure of enterprises to reinvest profits in capital equipment may lead to catastrophe. For example, the steel industry in America failed to make the necessary reinvestment in plant and equipment while at the same time paying excessively high dividends to stockholders and large bonuses to management. The industry under-allocated profits in one area and over-allocated profits in another.

2. In contrast, the public education system in America has been spending large sums of money on capital equipment in the form of plant and operating equipment. Unfortunately (I believe), this has also led to underspending for teacher development and utilization of new technology in the learning environment.

3. Another example of contrasting use of profits is found in the for-profit firms who annually contribute 5 percent of their pre-tax earnings to charitable giving. Compare this to the large number of not-for-profit organizations that have never given to a charitable cause.

No matter which approach you choose, you will be involved in most of the same activities. The differences from an operational perspective will be manifest by the fact that one approach will create a greater demand in one area of allocating profits than another. For example, stockholder return on investment in a for-profit enterprise will have to be high enough (or the promise of such, believable enough) for management to keep its job and not be turned out by the owners and/or investors. In the not-for-profit organization, management may be called on to generate a profit of a lesser magnitude for the purpose of creating a reserve fund but will have no demand for payment to stockholders or owners because there is none. The chart found in Figure 1 below demonstrates these variances in approach selection value/demand.

FIGURE 1

	Used auto dealer entrepreneur	Auto manufacuring corporation	Your organization	Law office partnership
research & development	L-L	M-H		L-M
return to investor	H-H	M-H		H-H
capital investment	L-M	M-H		L-L
employee bonus	M-H	L-H		M-H
management bonus	H-H	L-H		H-H
charitable giving	L-M	L-H		L-L
worker training & development	L-L	M-L		M-M

H = High M = Medium L = Low
The first letter is for value; the second is for demand.
For example: L-M = Low value, Medium demand

The values assigned to each allocation area are the values I believe those organizations have. The importance of this comparison is not how accurate my assigned values are, but that every organization will have different values that they ascribe to each area. In fact the values they place on allocated profits will also vary with time. A time of corporate growth in sales and profit will carry a set of circumstantial values; a time of falling profit and sales will carry other values for assignment of profits. Therefore, you must understand that the organization's selection of activities or products to deliver will effect profit and utilization. Additionally, there is a circumstantial dimension to demand (i.e., growth cycle or one of retraction) that will effectively cause profits to fluctuate and influence the allocation of resources.

I believe that these (and other similar factors) should have more to do with the choice you make between for-profit and not-for-profit approaches than any prejudicial societal factor. On one hand, if the organizational entity you are planning to create will place a high value on employee and management profit-sharing, the better approach to take in the development of your organization model is to use the entrepreneurial process to develop a for-profit corporation with an employee stock option plan (ESOP). If, on the other hand, your entity will place a low value on profit-sharing, a not-for-profit or private society may be the better approach to use.

Two questions must be answered to an entrepreneur's satisfaction before he will invest his talent, time, and other resources in a venture. The first question is: Will the difference between cost (expenditure) and selling price (revenue) be large enough to justify the commitment of resources? The second question is: Does a large enough demand (market) exist to justify (generate profit) the venture?

There are no standard, fixed or even "correct" answers to these questions. Satisfactory answers depend on the desired return that each individual entrepreneur wishes to obtain from the enterprise. The potential size and profit that must be generated by the organization to interest the entrepreneur, thus, is wholely dependent upon the entrepreneur's intentions and interaction with a linear scale of infinite values.

This is contrasted by the organizing board of a not-for-profit entity. It typically coalesces from a need to provide a specific service. Although the size of the need is just as important to such an organizing group as the value of satisfying profit needs is to for-profit organizations, the emphasis on profit takes a different tack. The discussion of anticipated profits (paramount to the entrepreneur) is replaced with a discussion on where and how enough money will be raised to pay the cost, whatever that cost will be.

Cost

Let's look at the issue of cost and how it relates to the two approaches.

An entrepreneur operating a for-profit organization must constantly analyze cost data to determine how the organization's product or service will be positioned in the marketplace. This analysis is essential because cost and market position usually determine the amount of profit that can be generated. If the profit margin is too narrow to meet the desires of the entrepreneur, the organization may test the selling price to see if it can be increased (and thereby increase the profit margin.) If the selling price cannot be increased, the organization's production methods may be analyzed to determine if improved methods, cheaper labor, or materials savings will increase the profit margin. If neither the selling price nor cost of manufacturing can be changed or improved enough to provide the desired profit, the project will be dropped and an alternative venture will be selected.

In contrast, when a nonprofit organization's board members review their work plan, they start by costing out the service or product they believe to be needed. Then they identify public and private dollars that may be obtained to purchase these services. In many cases, the amount is fixed because there is only one local, county, or state government to deal with. If the resources identified to support the services are less than the resources required to provide the services, the board will often limit the units of service or units of product available (to fit the available dollars.) Only if this is undesirable or unsuccessful will they make an effort to reduce cost through product redesign or service restructure. Because the board members usually have come together around a specific need, their attempts to redirect their business plan to an alternative activity are often not effective. Because they did not form the organization to operate as an enterprise but to meet a need of society, they are forced to simply operate within the available resources.

I believe the underlying question that service providers must ask is: Should the first goal of a not-for-profit organization be to deliver a desired (and is some cases a required) service? Or should the first goal of a not-for-profit organization be to operate a successful enterprise that delivers a desired service?

To operate a successful enterprise is the first goal (out of necessity) for all for- profit organizations (with the possible exception of special enterprises specially designed to produce a tax advantage through paper losses.) Not-for-profit entrepreneurs, on the other hand, may have forgotten this goal in their drive to maintain a cherished service. They need to consider two operating rules. They are:

1. If boards do not operate a viable (profitable) enterprise while they provide services, their organization will not be around to provide services.

2. If boards sacrifice service delivery and/or quality just to stay in business, their organization may not truly be serving their target population.

These are the extremes. Any organization, whether structured as either a for-profit entity or as a not-for-profit entity, can focus their efforts exclusively on generating sufficient revenue to stay viable as an organization. This intensive focus may lead the organization to provide no service of value. In contrast, any organization may also focus their efforts exclusively on the provision of services. This focus also has a down side. The organization may unwittingly over-commit resources to provide a service that will eventually put the organization out of business.

Although pressure for higher profit is greater in most for-profit organizations than in not-for-profit organizations, the desired profits can usually be generated by effective and efficient management with no more negative effect on quality of service than similar efforts to improve ineffective management in a not-for-profit organization. Therefore, both organizations' approaches are viable and should be carefully studied relative to other factors before making a decision to choose one approach over another.

Approach Advantages and Disadvantages

What are some of the advantages of each approach?

First, each approach can be said to have advantages in the tax arena. A not-for-profit organization will not pay taxes. This should reduce operating costs thereby allowing the organization to deliver more units of service to the target population for the same amount of purchase of service dollars, grants, and/or charitable gifts. However, the for-profit organization's entrepreneurs will be less encumbered by government controls and regulations because they will not be subject to constraining not-for-profit laws.

Second, the not-for-profit organization's structure and its operating policies and procedures are more politically based than the for-profit organization's. Note for example, that in Minnesota a not-for-profit employer of persons with disabilities (using community-based employment funding as well as purchase of service dollars) must comply with a state regulation that dictates the size of the board of directors and the source of the directors' memberships. In contrast, an employer of persons with disabilities, also using community-based employment funding but organized as a for-profit entity is free to structure the organization as he/she pleases. The old saying, "There is no free money," however, is very true. The value of the advantages of not-for-profit must be carefully weighed because the costs could be greater than that value.

Influence of service type

A strong bias still exists in our society that certain services should not be delivered by for-profit organizations. These biases may act as advantages or disadvantages to the providers of specific services based on: 1) the approach they choose and 2) their reputations.

On one hand, if we were told that our church had been taken over by U.S. Steel and our pastor will be come a contract

employee of that corporation, I'm sure there would be greater negative ramifications to those who implemented this decision that they would care to manage. If, on the other hand, we were told that our local low income housing project had been taken over by the Disney Corporation, many of us would have an expectation of improved service. However, what if it were your church that Disney took over?

As to the role these social prejudices play in approach selection, that decision must remain with the developer/entrepreneur. Only the developer/entrepreneur can answer the question: Will the gain be significant enough to overcome the risk of losses?

Inexperience is to blame for the faulty reasoning that leads to the belief that once a choice is made to organize as a for-profit or not-for-profit, that choice is final and irreversible. That, of course, is not true. In fact, in some cases it may be appropriate to design an organizational entity by planning to make a transition from one model to the other. In other cases, re-assessment after start-up may lead to a planned transition.

Minnesota Diversified Industries (MDI) in St. Paul, Minnesota conducted operations using a not-for-profit corporate structure from 1964 to 1988. From 1964 to 1968 it was a church-affiliated agency, and from 1968 to 1988 it was operated as a private, not-for-profit organization. In 1988, however, management recommended to the board of directors that they consider starting a for-profit subsidiary for the purpose of testing the use of that organizational approach on the business of employing persons that are hard to employ and/or disabled. At the same time the board would be testing the effects of taxes and other factors related to the for-profit world using this approach.

The board agreed to test the service by organizing a new corporation call MN. P.A.C. (later chapters provide an example that describes how MN. P.A.C. was developed using the entrepreneurial approach). In this text, however, it is referred to as Model X or Corporation X.

The ability to selectively switch approaches

It is conceivable that there could be, at a later date, a sale of MDI's private, not-for-profit business base to MN. P.A.C. This would only occur after MN. P.A.C. has proven itself (and its organizational structure around the for-profit approach) to be of more value to those seeking employment opportunities. The proceeds from the sale could then be used by MDI to start new services. In effect, MN. P.A.C. may also test the potentials of a transition from not-for-profit structured organization models to for-profit models. Of course, if MN. P.A.C. does not provide the desired profitability and remediative values to MN. P.A.C. employees, the MN. P.A.C. board could donate the entire corporation and all of its assets to MDI. Even if this happens, the MN. P.A.C. test would provide an example of transition from a for-profit organizational structure to a not-for-profit organizational structure.

Making the Approach Decision

Not-for-profit organizations have a host of advantages. They fall into two groups: 1) those that are universal and, 2) those that are site or project specific. An example of a site specific advantage is found in the State of Minnesota. If a board member of a not-for-profit organization serves without a fee or other financial gain, he or she is protected by state law and not liable to a lawsuit. Most other states do not provide this protection. An example of a universal advantage is found in the legislation of fund raising. By using a not-for-profit structure a new organization may come into existence without a large debt to service.

Another potential advantage of a not-for-profit structure to an organization (though not exclusive to not-for-profit's) is the use of volunteers. For example, as a not-for-profit organization MDI is able to recruit chief executives from major corporations for its board of directors and advisory or ad hoc committees. In the for-profit world, there are groups of individuals (e.g.: S.C.O.R.E. of the Small Business Adminstration) who provide volunteer help to entrepreneurs starting up a new enterprise. When they volunteer their assistance to profit-making businesses, however, they may need to accept some personal risk of a lawsuit from the public due to errors and/or omissions.

The not-for-profit organization has a special social role to fill that is often overlooked. Not-for-profit organizations provide opportunities for their employees to contribute to the social well being of the community, though the employees'

major energies are directed at obtaining financial gains for their families. The not-for-profit organization, thus, helps to create a balance in our lives. Rather than a single focus of self, we citizens are able to broaden our participation in activities of social value to our community. Over time, the employees of not-for-profit organizations tend to develop loyalties that deepen in commitment. Their participation may start as they share special talents and skills. As their participation "ages," it may progress to the provision of direct financial assistance and/or into the arena of advocacy for "the cause."

Voluntary community activities become so highly valued that in some corporations it may be difficult to move into an upper management positions without pointing to a record of social service to the community. Thus, service as a board member on a not-for-profit organization is, under some circumstances, viewed by society as a highly valued activity.

As boards deliberate the factors discussed above (the factors that actually drive the model selection process) two other activities should also be completed; completed, in fact, before making a final model selection. These essential activities are: 1) Writing a mission statement, and 2) Constructing an issues consideration chart.

Writing a mission statement

All organization planning should be prefaced by the development of or review of the mission statement for the entity under investigation. With the mission statement in hand (and understood by all stakeholder/decision-makers), written objectives that will be reached during the first three years of the organization's operation, must be developed. These documents will serve as a base for the rest of the planning and decision-making that follows.

Constructing an issues consideration chart

Using the mission and objectives statements as an operating platform, the planning should now turn to the construction of an issues consideration chart. This chart simply provides a visual organization tool to help identify and describe the major features of the planned organizational operation. The chart is evaluated to determine if any advantages are provided by the selection of a for-profit over a not-for-profit organizational structure.

An issue consideration chart for Corporation X is illustrated in Figure 2 below. It will be used together with the value demand chart created earlier, the mission statement, and the objectives statements describing the intent of the organization over the next three years. The comparison/contrast of these documents will help organizational planners make their structural decisions. At this stage, as at any stage, the decision regarding organizational structure is not irreversible. Therefore, it pays to be thoughtful and creative, but not so strident on yourselves that you lose sight of the goal.

FIGURE 2

Corporation X Issues Chart

Issues considered in model selection	Advantages: For-profit	Advantages: Not-for-profit
FINANCIAL		
Availability of charitable funds		X
Foundation loans (P.R.I.s)		X
Bank loans	X	X
Venture capitalist	X	
Sale of stock	X	
Depreciation of assets	X	X
Endowment fund		X
Retained earning		X
Real estate taxes		X
Sales tax exemption	X	
Restriction on borrowing by lead bank	X	X
Government loans	X	X

Issues considered in model selection	Advantages: For-profit	Advantages: Not-for-profit
GOVERNANCE		
Board of directors without restriction		X
Officers of major firms on board	X	X
Joint venture with for-profit	X	X
Joint venture with not-for-profit	X	X
Ownership by officers	X	
Ownership by employees	X	
Corporate acquisitions	X	X
OTHER		
Restriction on budget (ex. United Way)		X
Utilization of surplus properties		X
Management bonus plan	X	X
Employee bonus plan	X	X
Special Government Purchasing	X	X
Employees' stock ownership plan		

Chapter Three

Planning and Implementing the Entrepreneurial Concept

Congratulations! I assume that you have selected the entrepreneurial approach to structuring the delivery of a social service or you would not read this chapter. Your task now is to construct an implementation plan that will guide your activities over the next year to year-and-one-half.

In the story of Alice's Adventures in Wonderland, young Alice asks the Cheschire cat, "Tell me, please, which way I ought to go from here?" The cat replies, "That depends a good deal on where you want to get to." When Alice answers, "I don't care much—where." The Cheshire cat responds, "Then is doesn't matter which way you go!"

The entrepreneurial approach, thus, is best implemented after clearly choosing not only what you will do, but also the criteria that you will use to evaluate your progress and accomplishments. Later I will discuss twenty-six elements that will guide the development of your implementation plan and plan schedule. These documents, however, should be developed only after you have written a mission statement—one that has been endorsed by those stakeholders who are responsible for the venture.

Building or Burning Bridges

Some people do not believe that a successful transition into a new service option may be made if the service provider attempts to maintain a link to existing services. I feel, however, that this view is contrary to what we know about natural growth.

If I were the captain of a ship and wanted to be certain that the crew of my ship stayed with me until I reached a distant land (where I believed all aboard would experience an improved life), I could destroy the lifeboats. If the trip became rough, the lack of lifeboats would be certain to focus the crew's full attention on saving the ship (at any cost.) Further, once our ship had landed I could order the ship burned immediately, thus obtaining a guarantee that the crew would strive to live under my direction because the option of return did not exist. As Captain of such a venture, I would be forcing changes by burning the bridges of escape.

Change by force (burning your bridges) is one approach to entering entrepreneurial ventures. However, it is not the best approach for encouraging personal growth. Nearly all people eventually decide to leave their parents' home. Those that know that they can return if problems arise or if they discover they really weren't ready, leave with greater confidence. Their added confidence in fact, gives them an edge, making them more likely to quickly succeed. Did your parents sell your furniture and board up your room the first day you left home? Most didn't. Most of our parents were supportive and helpful and monitored our progress. We were comfortable knowing a bridge remained.

Those service providers who insist on burning bridges and closing down all options but community-based employment to achieve normalization success are doing a disservice to us all. Maintaining options is more respectful to all individuals and may, in fact, offer the confidence that makes entrepreneurial ventures more likely to succeed.

Organizing the Decision-making Process

To help put all of the considerations of values, costs, prejudices, and other issues into a framework of decision-making, some entrepreneurs find it valuable to create and utilize a task force. The task force will be initially charged with the job of examining the organization's entrepreneurial desires from the perspectives of profit, value, and cost (described above.) Their job will be to carefully weigh the organization's mission statement and determine how a new mission

statement (created to guide the development of a new service delivery system) would interface. In addition, the task force will be given the responsibility of examining the advantages and disadvantages of the various operational models a new service delivery system could create.

Your board of directors should authorize the creation of this task force. However, the chief executive officer (CEO) should appoint the task force members. The board should also issue the task force its charge, establish investigative time frames, and authorize the members to conduct limited needs assessment and market research. Both the CEO and board chair should be members of the task force.

Reaching conclusions regarding the issues of profit, value, and cost, the task force will make recommendations to the board regarding the further development of a new service delivery system using an entrepreneurial approach. Their recommendations, both positive and negative, then become points of debate for the board. If the board agrees with a recommendation calling for further investigation, the task force should be charged with narrowing the operational choices.

The task force is likely, at this point, to conduct a community-needs analysis. The committee members should be given encouragement to develop an open, entrepreneurial attitude toward their work. No delivery service system, market opportunity, or manufacturing idea should be discarded without serious consideration.

Nevertheless, the task force should confine its study to an examination of readily available market climate documents and a few interviews with stakeholders and industry leaders. At the same time, the task force should be investigating the organization's capability to support an entrepreneurial enterprise. Both of these investigations will be intensified in the initial screening, with the intent of obtaining evidence that the organization would be successful in its entrepreneurial effort. The task force will again make recommendations (in a report) to the organization's board.

At this point, the board must make a go/no go decision regarding further study and the planning and implementation of an entrepreneurial effort. The board, if choosing to continue the investigation, will authorize a complete marketing audit. This audit will most likely be conducted by a committee, but not necessarily the same task force used for the preliminary investigation. Many types of industries may be suited to development using an entrepreneurial approach. It will be the committee's responsibility to identify viable business options. (Remember that viable must be taken in the widest possible context.)

A marketing audit entails gathering as much data as possible from experts and other sources regarding a potential market area. The audit will produce a profile of the products and services under investigation, including market or market segment size, preferences, and response medium. Because the scope of the audit may be quite large, the board will typically charge the committee with an audit that is limited by type, dollars, or some other variables. Like the preliminary study, the committee's work should be prescribed and time limited by the board.

Based upon the marketing audit, the organization board now determines if resources (time and finances) should be committed to the entrepreneurial effort. In some cases, the commitment of resource must reach well beyond a simple go/no go decision. For example, if a complete conversion from a not-for-profit enterprise structure to a for-profit structure is contemplated, a lengthy transition process may be needed to ensure that all stakeholders are satisfied and all existing relationships with other organizations are effectively involved in the transition.

An Entrepreneurial Approach to Goal Setting

When giving life to a new enterprise, some entrepreneurs look for a person or firm that they hold in high regard after which they may pattern their enterprise. For example, the creators of a new venture may choose to model the corporate climate found at the 3M Company. To impose their model, however, they put into place constraints that may limit the options available. Their goal ceases to be "develop a successful venture" and instead becomes "develop a venture like 3M." Such a pattern of constraints at this early stage could result in casting aside opportunities and challenges because they did not fit the 3M model.

The alternative, entrepreneurial approach stresses the new venture's opportunity to become an unique entity...unlike

all other ventures. This approach imposes no limitation other than the use of good business practices. Quite often individuals using the entrepreneurial approach will be described as opportunistic. Although this is true, their opportunism should not be construed as "without principles."

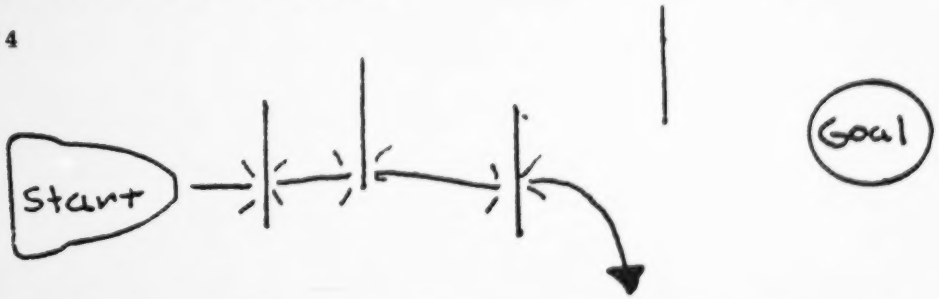
Individuals choosing the entrepreneurial approach to organizational development must be experienced and skilled in the making of systemic decisions. A paraphrased example from Wolfensberger best exemplifies the principle. To describe the scene of a civil disaster just after a medic arrives he indicated that there were three major groups of victims: 1) Those so severely injured that even with help they will die; 2) Those who with immediate help may or may not live; and 3) Those who will live even without immediate help. The medic, exercising systemic decision-making skill, would immediately begin to provide assistance to group two. Only after all individuals in group two had all been helped, would the medic assist persons in group one or three. This ability to identify ventures that may succeed with help must be developed by the successful entrepreneur.

Some people only know one direction—straight ahead—no matter what the obstacles are. This is usually because people have their goals defined within a narrow range.

FIGURE 3

The first example (Figure 3) illustrates the position of an administrator who has defined organizational goals that are distant enough to obtain a clear view of the field of opportunities open to them. This administrator will, therefore, be able to channel organizational resources in a manner that will circumvent obstacles. Less wasted efforts (translated to mean less lost time and dollars) will result.

FIGURE 4



The second example (Figure 4) illustrates the less efficient option: formulating and following a series of short range, and likely short-sighted, goals. Because this administrator does not have a long-range view that might be exploited in an attempt to steer the organization away from hidden obstacles, time and effort resources may be wasted meeting limited goals. The organization using a short planning horizon must meet each obstacle and overcome it before attention is turned to new directions. This is rather like trying to steer a car by looking directly in front of the hood. The driver continually over-steers. By simply looking down the road 30 or 40 yards, the driver could more easily direct the vehicle in a smooth manner, without over-steering.

Earlier, I recounted the story of Alice in Wonderland. The direction you take is only important if you know where you are going. Organizationally, the entrepreneur must begin with a clear definition of the final objective.

A Discussion of Stakeholders

Even a simple analysis of the identity and roles of organizational stakeholders is very complex. The difficulty is

compounded when the stakeholders interest and responsibilities are also under investigation.

The analysis of stakeholders in even a seemingly simple enterprise can be complex. For example, in a teenager's babysitting venture there are several obvious stakeholders—the sitter and the parents of children being cared for. However, other stakeholders also exist. They include: 1) The children the sitter cares for; 2) The sitter's parents, who are still caring for the sitter; 3) The sitter's siblings; 4) Perhaps even the sitter's neighbors, and neighbors of the children who are being cared for and many others. (See Figure 5.)

FIGURE 5

Stakeholders in Babysitting Enterprise

Stakeholder	Interest	Responsibility	Potential Input	Our responsibility to them
You	Income, working conditions, family responsibility	Help earn your own money; help care for children at home; care for children of other family; fulfill terms of contract	Selection of families you would work for; request release from care of your younger siblings; express your wishes	Make the best possible selection; enjoy the opportunity; best possible performance
Family you would work for	Ability to attend functions inappropriate for children; to get away from their children for mental health	The best care for their children they can afford; to get away to preserve their ability to parent	Can qualify you as a potential candidate; can request your services; can dismiss you for nonperformance.	Perform in accordance with contract; provide candidate honest information; best quality possible
Your parents	Your well being; care for their other children; need for additional income for family	Care for you and your other siblings; to screen other family; to support your growth by moving outside the immediate family	The final decision rests with them	Request their permission; respect their decision; perform those tasks assigned in accordance with family policy
The children you would care for and your siblings	To feel safe; have fun	To accurately report quality of services you provided; cooperate with you while being cared for	Advisory to parents as to performance	Perform to the best of your ability
Neighbors of both households	A quiet, safe neighborhood where all children are being cared for	Report infractions or problems to parents or authorities	Advisory to parents as it relates to perceived quality	Perform to the best of your ability
Local savings institution	Your earnings deposited with them	To prudently invest it; return on request with interest	Requests consideration as the place of deposit of earnings	Give them consideration as a place of deposit

The identification of stakeholders in a venture as diverse as the provision of a rehabilitation service venture (compounded by the need to understand these stakeholder interests, responsibilities, and potential input) is even more complex. Figure 6 on page 19 identifies some of the most obvious (and most commonly listed) stakeholders. However, the list is by no means complete. It should be edited and expanded to clearly reflect the stakeholders in your specific venture.

Not all stakeholders will need to be considered as equal partners (providing resources, interest, input, time, other

resources) in every venture. Accepting all interested parties as equal partners assures long delays and unsatisfactory compromise solutions when complex organizational problems arise. Effective service delivery would be the fatality of such a system.

The process of planning and initiating Corporation X involved (among many other tasks) the identification of stakeholders. Many stakeholders were identified. The listing in Figure 6 below is an incomplete sample of those that were identified, along with their major interest in the venture opportunities that we were examining. Periodic review of such a list during the development process (with additions or deletions made as necessary) may help the administrator maintain a clear grasp of potential resources. Such a list could be exploited for its potential to help the administrator identify and spark interest in the organization's venture with potentially crucial stakeholders.

FIGURE 6

Stakeholders	A major interest in Corporation X
MDI Board of Directors	Maintain quality employment opportunities for underemployed.
MDI employees	New options for employee ownership.
Foundation that supported MDI	That MDI not be placed in a situation of unreasonable risk.
Parents of MDI employees	To make sure Corporation X does not drain off resources needed to maintain viability of MDI.
State government	To be informed so as not to be embarrassed by not knowing about Corporation X.
Local government	To receive information that would be useful in developing their local plan for delivery of services to the hard to employ.
Corporation X Board	To be assured that the planning has been of Directors done to carefully to afford a reasonable opportunity for a success.
Corporation X	A chance for a career rather than just a job employees and for the opportunity of ownership.
Local United Way	A possible reduction in the future demand for their oversubscribed funds.
Local politicians	An opportunity for associations and identification with a winner.
Local A.R.C.	An alternative opportunity for those under-served by current in-house or community-based programs.

It is important that identified stakeholders be given an active role in the investigation, development, and implementation of any entrepreneurial venture. Identification of major stakeholders is only the first step in the process. The administrator's responsibility to each identified stakeholder must be individualized. Some may only need to be kept informed. Others may be integral to the locating of resources or key to the planning process. Resist the temptation (and, possibly, pressure) to overtax your new venture's development by trying to make everyone an equal partner or believing you can satisfy all of the stakeholders equally.

Fiscal Planning

Concepts and terms

Understanding the financial section of the venture's business plan requires an intimate knowledge of some key

financial concepts and terms. Before any administrator attempts to obtain start-up financing for a new enterprise, a well thought out business plan incorporating the concepts and terms used by lenders must be in place. This is essential to maximize the probability of successful capitalization.

Nothing short of loan failure is as distressing to a loan officer (and as negatively perceived) than to be forced to discuss and deny a loan request from public service providers who did not understand either their own needs or the needs of the banking community. This section was very nearly titled: "How to avoid looking like a bush leaguer when playing in the big league."

Few enterprises can be successfully launched with little or no financial capitalization. Those that can are usually special service providers, such as janitorial or maid services. Many of us can remember doing jobs that required low capitalization such as children-babysitting, delivering newspapers, snow shoveling, lawn care, etc. Although we did not think of these jobs as business enterprises, they all have every basic element found in the most complex service industry entity.

My first venture was a Kool-Aid stand. Can you remember yours, sitting in front of your home or your friend's? Most often we always chose a safe start —where we felt minimal risk (unless, of course, our friends were experienced Kool-Aid entrepreneurs.)

To construct our first stand, we used a wagon, a piece of plywood, and a bath towel cover. All of this was obtained at very favorable terms, under a no-cost lease from Mom and Dad, and my brother Jim (the wagon) who was too little to demand a vested interest.

My friends and I located our stand on the sidewalk by the stairs in the front yard. There we had a place to sit without carrying any chairs out of the house, thus avoiding unnecessary resource expenditures. We were ready to go into business, or so we thought.

It was at that point that we recognized a need for glasses in which to serve the Kool-aid and some sort of a thermos to keep our supply cold. This would complete our capital equipment needs. However, because we had no money to buy this equipment, we hoped to further extend our favorable lease by using my mother's glasses and thermos. At this request, she demanded a higher cost for the lease...a promise to return them to the house when we were finished, and to pay for any broken items.

Our marketing strategy was limited. We recalled that the Robertson kids on second street were charging three cents a glass, so that would be our price. So much for expensive market research. The three cent price level, however, created a potential need for change. (Even though our affluent neighbors were still without credit cards, they did have dimes and quarters and would demand change. Even with a pricing strategy of four-for-a-dime or two-for-nickel, who could drink four glasses?) Our need to obtain change introduced us to the necessity of working capital.

Along with our need to have on hand pennies, nickels, and dimes for change, was our need to stock consumable supplies...Kool-Aid and ice cubes. Of course the ice cubes had a very short shelf life on a hot day. My mother was ready to take advantage of the situation. Deep down she always wanted to be a venture capitalist (though she pretended that she wanted to create an opportunity to learn about the use of money.)

She seized the situation, forcing me to sit down at the kitchen table and figure out the cost for the items we needed as shown in figure seven below:

FIGURE 7

Change required	.40
Smallest block of ice	.25
Kool-Aid	.10
Sugar	.15
Total venture capital needed	.90

This completed, she informed me that she would allow me to take the supplies on credit, expecting repayment that evening.

If we had set our price correctly, after selling all of our Kool-Aid and ice inventory we would have generated enough sales revenue to pay off Mom, who had played the role of a venture capitalist by providing us with working capital. Because we had never been in business and had no track record to recommend us, she really had given us a venture capital loan. Unfortunately, our inexperience showed. We gave away too many free samples (though only to our closest friends), and provided freely for our own thirst. When the Kool-Aid was gone we found that we had total cash receipts of only 60 cents.

Forgetting our obligations, figuring that we had put in a good day's work, and figuring that 60 cents was really a lot of money, we provided ourselves with some owner's compensation in the form of one ten-cent candy bar each. That even left 40 cents for change the next day.

At this point, we made three major mistakes: 1) We took our owner's compensation from our working capital; 2) We took for granted that the credit terms of our capital equipment suppliers could be extended; and 3) We were unable to repay our venture capitalist at the appointed time.

When we arrived home, my mother asked for a profit-loss report on our activities. I showed her the 40 cents we had left and told her how profitable the day had been. She pointed out that we had invested 90 cents to make 40 cents. Telling her that we had each purchased a candy bar, so our earnings were really 60 cents on a 90-cent investment, proved to be a bad decision. I was sure that I was out of business for good and that I would probably be without an allowance for the rest of my life (the time it would surely take to cover the unpaid debt.) However, we weren't let off that easily. We were forced to revise our business plan for the next day to allow us to pay off our outstanding debt.

The new business plan called for the elimination of free glasses of Kool-Aid (to good buddies and ourselves.) This was to be accomplished by moving our stand out of the neighborhood so that our friends would be less likely to pester us with "freebie" requests. We choose a construction site where (we had been told by some other kids) workers would pay 5 cents and sometimes say "keep the change" when they paid with a dime. Thus, our new business plan targeted a market segment that could increase our profits and provide price consistency. We saw a real working plan coming together and sat down with my mother to put it on paper as shown in Figure 8 below:

FIGURE 8

1. Location—construction site
    a. Possibility of a better price for our product
    b. Chance for windfall revenues (tips)
    c. No free ones for friends
2. Owner's Compensation
    a. No payment until working capital was restored.
    b. No payment until venture capitalist was paid.
3. New credit line for supplies would be based on higher price of 30 cents rather than the 25 cents for the first day.
4. Venture capitalist would be paid off for both outstanding and new debts before we were ever to receive an allowance again.

At the end of the second day, with supply loans and debt to venture capitalist paid (once again entitled to receive an allowance) the business was liquidated before any other problems surfaced. After all, we had things to do that summer and an ongoing business with its many demands did not fit into our plans.

Developing a lending relationship

The typical first-time entrepreneur typically has very little cash assets. The lack of a loan and/or business record makes the task of raising cash from traditional lending sources difficult. The first task that must be undertaken to help surmount these problems is to build a business plan strong enough to interest a lender. One of the most important segments of that business plan is the financing section. You must build a financing plan that will help convince a lender that your business enterprise is low risk. The object is to obtain a loan at a favorable price. The underlying principle of the risk/price relationship is easily grasped—the higher the risk, the higher the price of money.

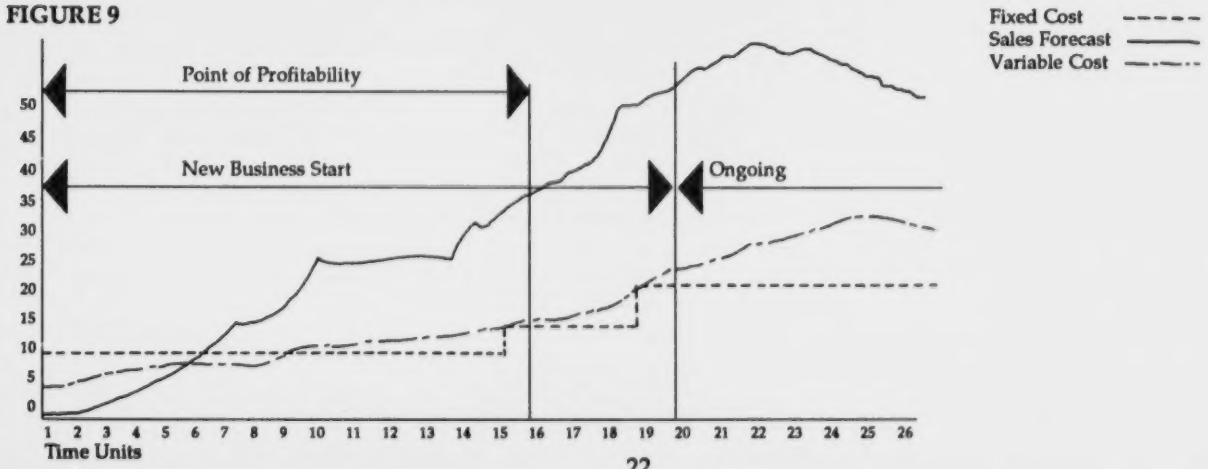
Loans for enterprises with no track record, even with a well-developed plan, will still be two to four percent above the prime rate. The entrepreneur must put forth every possible effort to reduce the need for borrowed funds. The less the need to pay for cash assets, the greater the expectation of profitability.

As Kool-aid stand entrepreneurs, we worked out favorable lending arrangements for all of our capital items and chose a business that allowed us to operate without a physical plant (by relying on public areas for our contact with customers.) In fact, our Kool-aid stand business venture would not have been feasible if we had been required to purchase even one of the capital items.

Unproven entrepreneurs must attempt similar measures. They must minimize their need to purchase plant and equipment to reduce the need to obtain financing from a venture capitalist. This essentially requires the completion of a thorough market analysis. The analysis will hopefully provide data useful for developing insights into potential ways that might maximize profit margin (the construction site—not the front steps). The bottom line in arranging financing will be the difference you are able to generate between the costs incurred producing and selling your product/service, and the revenue that is produced through the exchange. Although this margin may be increased by either increasing the price or reducing the expenses, in most cases it is far easier to increase the price of your product/service than to reduce the expenditures incurring to produce products or provide services. However, even increasing the price has its limits. (We would never have been able to sell Kool-aid for five cents in our own neighborhood. The market price was three cents, and that was that.)

The determination of the level of need for venture and/or working capital may be made easier by graphically displaying the multiple factors that affect the needed level. Figure 9 illustrates such a graphic display. It shows the planned operational results of an enterprise using a value verses time axis. Note the independence of the three trend lines. The sales (or income) line starts at zero. (It is rare indeed for a new venture to have an existing sales base.) As the venture matures, sales climb steadily higher. At some point, however, sales saturation occurs. At this point, the market demand has peaked and sales will begin to decline without the introduction of a new product or service.

FIGURE 9



The cost of goods in Figure 9 is represented by two lines—the variable cost line and the fixed cost line. These two, combined, represent the total cost. The difference between the sales line and the sum of the variable and fixed cost lines is the before-tax profit (or loss).

For example: The graph at timeline 1 (represented by the number 1 at the bottom of the graph) illustrates a new business start-up phase. It show us the values illustrated in Figure 10 below:

FIGURE 10

2	dollars	units of sale
minus - 11	dollars	units of fixed cost
minus - 5	dollars	units of variable cost
equals - 14	dollars	units of loss

Other points on the graph illustrate the condition of the enterprise at different times during the investigation period. At timeline 16 the graph first shows that the enterprise is becoming profitable. It shows us the values illustrated in Figure 11 below:

FIGURE 11

35	dollars	units of sale
minus -15	dollars	units of fixed cost
minus- 15	dollars	units of variable cost
equals 5	dollars	units of profit

Although timeline 20 is not the exact point where the venture becomes profitable (because other factors also play a role in profitability) it could be used to mark the transition from a new business start-up to an ongoing business entity. Another way to view this point is to use it to mark the business's transition from reliance on venture capital to the development of working capital. A well-designed business plan would not, in fact, show such a capitalization transition at this point. It should always build in a margin for error.

Fixed versus variable cost

After seeing Figure 9, inexperienced entrepreneurs often ask: Why do you allow the fixed cost to get so far out ahead of sales? The reason is simple. Even when the enterprise is in its earliest stage of operation, many basic cost centers must be in place that do not vary on the basis of sales volume. They include: phone service, insurance, heating, cooling, and rent. The business owner must install the whole phone, not just the receiver; and the insurance company will not sell you fire insurance to cover only those days that you had sales. Thus, very few businesses will not be in the position of having fixed costs disproportionally higher than sales as they begin operation. Additionally, rather than following a curve upward, these costs tend to jump up in steps, even in a mature business. Therefore, your business plan will show a gap in the start-up phases. The venture capital source will understand this gap as a normal phase of business.

Variable costs may almost shadow sales in a well-run organization. Variable costs are directly related to the sales of your product or service. They are principally costs incurred for the labor and materials used to produce a product or a service. Some cost overruns should be expected at start up. New workers, after all, will not be very efficient during this training period. One attribute of a well-run enterprise is its ability to bring these costs under control quickly.

Determining capital required

To determine the enterprise's need for capital, refer to figure 20 and compute the average of each trend line over a period of time. Starting with sales: 1) The average value between time 1 and time 16 is 14, therefore, 16 x 14 = 244 dollar units for total sales; 2) The average for fixed cost during time 1 and time 16 is 12, therefore, 16 x 12 = 192 dollar units are needed to account for total fixed cost; 3) The average variable cost during time 1 and time 16 is 7, therefore, 16 x 7 = 112 dollar units for total variable cost. With this information, we can calculate the average need for capital during the time period 1 through 16 as illustrated in Figure 12 below.

FIGURE 12

Total sales	244 dollar units
Less total fixed cost	- 192 dollar units
Less total variable cost	- 112 dollar units
Equals	60 dollar units of capital required

To establish a line of credit, the entrepreneur must also know the highest cash requirement during that same time period. Referring to Figure 9, the difference between sales and the sum of fixed and variable costs for each of the time periods 1 through 20 are established and added. Beginning at time unit 1 the entrepreneur makes the following calculation: (sales 2) - (fixed cost 11 + variable cost 6) = 15 negative. Continuing this process for each time period, values are obtained for all periods. A good business plan would calculate all values at least through timeline 20. All of the negative values obtained during this process (moving from 1 to 14, where the graph indicates that the enterprise become profitable) are now summed. This figure (expressed as a positive number) represents the least amount of capital needed to operate the new enterprise. To this figure is added an additional computation. The cost for any needed equipment and other fixed assets is calculated and added to the figure determined above to obtain the actual amount of venture capital that will be needed.

One of the most disastrous errors that a first time entrepreneur can make is to borrow less capital than is needed to stay in business until the enterprise becomes profitable. This condition is referred to as "getting half a loaf." The mistake is usually made in a mistaken attempt to reduce the cost of borrowing or in the mistaken perception that the level of risk may thereby be minimized. Under capitalization results in the negotiation (by management, the venture capitalist, or lending institution) of a line of credit that will not provide the needed cash as the business struggles though its first months. If cash flow does become a problem, managers will be forced to fight financial problems. This takes their focus off things that could lead to profitability. In most cases this strategy ends up either costing the mangers more (out of profit) due to some high-cost secondary borrowing, or causing the financial failure (bankruptcy) of the enterprise.

Remember the following key points while doing your financial planning:

1. Plan well
2. Understand your needs
3. Communicate carefully and thoroughly
4. Shop for the best interest rates (but remember that too small a line of credit could put you out of business)
5. Err by asking for too much capitalization rather than too little. (It's always better to exceed a reasonable plan than to fail with too aggressive a plan.)

Monitoring the operations

Controlling functions must exist in all enterprises. The responsibility to monitor these control functions will be assigned to one or more individuals, depending on the size and structure of the enterprise. The controller is responsible for monitoring the organization's cash resources, and for providing all data regarding these resources to managers, directors, administrators, etc. who control their expenditure. The position of "controller" is usually cited as an example of an internal monitoring system. However, the functions of this position may be provided by contracted services for some organizations. Most management reporting systems are actually a blend of reporting for information purposes and for auditing purposes, such as the use of monthly cash flow reports (representing internal auditing) and an annual report prepared by an independent CPA firm (representing external audit.)

Figure 13 (page 26) is an example of one of the management reporting systems used by MDI. On this form, each of the five major segments is part of the reporting system:

A. Priority activities for the week (in order of importance)

B. Need for assistance from others

C. New resources required within area of responsibility

D. Corporate concerns of identified needs and opportunities

E. Major accomplishments during past week

Item A has the appearance of straight forward reporting until you read carefully the last phrase "in order of importance." This is what reclassifies it as a monitoring tool as well. By forcing an order of priority, the reader can understand what is most important in the context of what is a priority.

Item B, if left blank week after week, may document the fact that the person charged with a reporting task does not place a high value on assistance from others and must be held suspect as to his or her ability to be a team player.

Item C is basically a request for a larger share of resources or for new resources.

Item D if week after week is restricted to concerns within personal areas of responsibility will strongly indicate a lack of awareness of the whole picture.

Item E is the key to monitoring. It can be compared with previous weeks to identify a person who procrastinates or a person who is able to set priorities and accomplish them.

In one-on-one meetings with managers, the entrepreneur wants to know what they are thinking. These reporting systems are aimed at seeing what they are doing. However, if they can tell you what they are thinking, the entrepreneur will be able to understand why. Managers continue to rely on reporting systems because it is easier (and, perhaps, safer) to report than to state what they are thinking. Nevertheless, a means for understanding what managers think is important to work into your management system.

Another problem in the management of a new enterprise is the failure to develop key internal monitoring systems. These systems are essential to the establishment and maintenance of good business practices. This is especially true in small enterprises. In larger businesses, several key individuals are often assigned specific monitoring functions and required to report on their activities and observations on a regular basis. In contrast, smaller enterprises may rely on only one individual (often the founder and boss) to provide all monitoring and controlling functions. If one person wears too many hats, they often let the dull and routine tasks (and lets face the fact that most controlling/monitoring functions are dull and routine) fall behind.

FIGURE 13

WEEKLY MANAGEMENT REPORT

Department: _____ Date: _____

Name: _____

Manpower changes: _____

_____

Anticipated Manpower Changes: _____

_____

_____

A. Priority activities for the week (in order of importance):

1. _____

_____

2. _____

_____

3. _____

_____

4. _____

_____

5. _____

_____

B. Need for assistance from others:

1. _____
2. _____
3. _____

C. New resources required within area of responsibility:

1. _____
2. _____
3. _____

D. Corporate concerns of identified needs and opportunities:

1. _____
2. _____
3. _____
4. _____
5. _____

E. Major accomplishments during past week:

1. _____
2. _____
3. _____

Monitoring finances

The financial well being of the enterprise is critical to its very existence from the beginning stages of planning through the day-to-day operations. Good financial management is necessary to meet the three financial challenges and the many financial responsibilities common to your enterprise. With appropriate attention paid to internal controls, the cost of operating the industry, including the cost of employing low productivity employees, can be accurately determined. Once the actual costs of the operation are known, combined with the cost of planned expansions and/or the upgrading of service, the actual short term and long term financial needs of the corporation can be predicted. From this datum the amount of sales and the size of loans that will be required for the financial operations of the industry can be determined. A reasonable derivation of need, such as this, helps gain the confidence of the financial and/or funding sources, thus ensuring sufficient financial support for the prosperous and successful continuations of the enterprise.

Sixty-six elements that need consideration

In response to the nearly universal problem of monitoring the financial well-being of any small business enterprise, the Small Business Administration published Management Audit for Small Manufacturers by Philip M. Faucett. This document is an excellent resource for establishing and maintaining an internal audit system in any small entrepreneurial business that is developed. (In fact, the Small Business Administration has many other documents that may be helpful as you prepare your venture.) Faucett's book provides a checklist approach to the eight principal areas (66 elements) that need to be considered at least on a yearly basis. This checklist includes many items that, at first glance, do not seem directly applicable to finances. However, all of the items in some way affect the ability of enterprise managers to control their costs. It is especially important that all of the elements are considered before the development of an new enterprise is undertaken. His checklist, with annotations to each section added, is found in Figure 14 below.

This tool is not really a start up check list. Such a check list is provided in the form of the implementation detail plan found in Chapter Four. Instead, this check list is an ongoing evaluation tool that should be used every six months to review your enterprise. After 15 years, I still keep a copy on my desk and at least once a year I pick it up and run a check on our controls and monitoring systems. However, this tool also will provide information that is exceedingly valuable tothe establishment of any enterprise using the entrepreneurial approach.

FIGURE 14

An Annotated Version of Faucett's 66 Elements

Section 1
ACCOUNTING

1. Do you have an accounting system which provides a variety of data for the entire range of management's needs? _____ Yes _____ No

An accounting system that develops only required tax and operating statements doesn't generate all the information you need. The accounts must include enough internal breakdown so that managers can isolate and identify the source and disposition of funds and correctly assess expenditures on different projects and products.

2. Have you had an independent accountant review your accounting system and chart of accounts within the past 3 years? _____ Yes _____ No

The accounting system and chart of accounts must be consistent with established practices, otherwise bankers, creditors, and other parties involved with the business will be unable to obtain data about the firm that is acceptable to them.

3. Do you prepare formal accounting statements at the end of each month? _____ Yes _____ No

Failure to prepare monthly statements is a careless habit. Furthermore, people who are involved with your business—particularly lenders—will not view such behavior favorably.

4. Have you asked your accountant to explain the purpose and significance of each account in your accounting system? _____ Yes _____ No

Many small business people have only a sketchy knowledge about the way in which accounting data should be viewed and interpreted. Get some advice on what people look for and why.

5. Are your books audited yearly by an independent public accountant? _____ Yes _____ No

You need the yearly audit to provide credibility for your business. Every management must subject itself to review through audits. The results are valuable in informing management about circumstances that need correction or a new approach.

6. Do you consistently apply break-even and opportunity cost analysis to your producing activities? _____ Yes _____ No

Break-even is the point in the production sequence when the profit point is reached. Opportunity cost analysis reveals the nature of alternatives which may be better (or worse) than the selected course of action. Both should be employed regularly to indicate the value of a particular project. You can find explanations of both analyses in books on managerial accounting and production management.

7. Are accounts receivable aged regularly? _____ Yes _____ No

Consistent attention to accounts receivable will reveal who pays, when they pay, and the proportion of profit generated by various customers. No business can afford to allow accounts receivable to be neglected. You risk the solvency of the business if you do.

8. Do you have a cost accounting system? _____ Yes _____ No

9. Do you know how to develop useful data through the cost accounting system? _____ Yes _____ No

10. Can you separate costs to a particular project when several projects are in process at the same time? _____ Yes _____ No

An ability to identify and measure costs is essential in any production operation. As a manager works with the cost system and data, he or she should develop measures which show the cost and profit margin in each or several projects in process. Production relays and overhead must also be assigned their proportionate costs to each project.

11. Does your accounting system provide for the funds and statements needed for payroll taxes and deposits, income tax deposits, and deposits and payments of unemployment compensation taxes and workmen's compensation liabilities? _____ Yes _____ No

The accounting system must include the proper accounts and schedules insure that all tax and form filing liabilities are met. For even a small business these may involve a substantial amount of money and quite a few due dates to be met to avoid penalty.

12. Is your accounting system adequate for business and immediately foreseeable growth? _____ Yes _____ No

An accounting system should be reviewed periodically to determine if it's providing what the business needs. Many people fail to take action in this area until long after changes should have been made. It's wise to review the system often, preferably with your public accountant. (Kline speaks of your accounting system, but remember it could be a contracted service as well as an internal system).

Section 2
BUDGETING AND EXPENSE CONTROL

13. Are the expenditures of your firm based on allocations established by a budgeting system? _____ Yes _____ No

The financial expenditures of a firm should be controlled by budgets which set the limits of expenditure for a given result. Without budgeting, the expenditures aren't well controlled and tend to be made as situations arise, not on a preplanned basis, as they should be made. Budgeting also establishes standards of performance for an expenditure and normally incorporates all parts of a business simultaneously. As changes in an operation occur, the effect of revised expenditures can be estimated and changes made to reflect the impact.

14. Are your budgets tied to set time periods, performance standards, and incentives? _____ Yes _____ No

The budget is primarily a control device, but it's also very useful for monitoring time periods and measuring results during such periods. In addition, budgets can be adjusted as management succeeds or fails in producing results as measured against the budget projections.

15. Do you require a budget proposal with any proposal for future business operations? _____ Yes _____ No

Business owners may not be as realistic as they should be about prospective activity unless they establish a budget for the job. Managers can be told to budget, but owners may become lax unless their bankers insist on such information. You've simply got to budget and repeatedly check performance to see how it stacks up against projections to maintain control.

16. Are budgets used to control the amount and rate of expenditures? _____ Yes _____ No

Unless budgets set an expected result, managers develop slack in their operations. At best, a budget is an estimate, but it's a best
estimate and must be respected as a measure against which results will be compared. If substantial deviations occur, whoever made the budget or whoever is subject to it must answer for the difference.

17. Does your budget provide rewards for improved performance? _____ Yes _____ No

You don't have to apply your budget system negatively. Improvements in performance versus the budgeted amount should be recognized as valuable achievements and rewarded. The idea that improvement is always possible and expected, however, soon turns budgeting control into a deadly "do or die" game which obscures the goal or creditable achievement.

Section 3
CASH MANAGEMENT

18. Are all cash receipts deposited to the firm's bank accounts? _____ Yes _____ No

All cash receipts rightfully a part of the business operations must be deposited in appropriate bank accounts. Withdrawals may follow, but all cash must be cleared through one or more of these accounts.

19. Are cash receipt records processed by two or more people working independently? _____ Yes _____ No

Cash receipts should be handled in all cases by two more employees. This won't absolutely insure honest and accuracy, but it will help to make theft and alteration of records to hide embezzlement unattractive.

20. Are all withdrawals of cash, for any purpose, controlled by numbered checks? _____ Yes _____ No

21. Are petty cash withdrawals by check only?

Some view withdrawals by management as a privilege which doesn't require a check. Others exempt the whole petty cash system from the check process. But no business should allow any cash to be removed from the firm without a check as a record.

22. Are cash receipts and checks deposited daily and only the minimum of cash carried over for the next day's business? _____ Yes _____ No

You may not be able to collect on a check if you fail to deposit it promptly, and cash on hand is a temptation. Make sure that cash is promptly deposited, even though sometimes it's a nuisance to go to the bank.

23. Do you continuously monitor and reconcile cash disbursements against the original authorizations? _____ Yes _____ No

Any form of disbursement requires reconciliation against the authorization. You may not need to reconcile 100% of the case, but you should make a random check of a sufficiently large sample to insure reliability. Make sure that the system is purely random so it can't be predicted by a would-be embezzler.

24. Are all payroll checks matched with employee names, time cards, and personnel rosters? _____ Yes _____ No

Each employee is due only one check for each working period. Double checks, fictitious names, and dummy time cards can all be detected by comparison with the authorized payroll list.

25. Are all checks and purchase orders pre-numbered and accounted for? _____ Yes _____ No

Numbering of these forms makes it possible to verify a payment or order with the original authority. Unnumbered forms can be used improperly and misuse may not be detected for some time. Numbered forms should be strictly accounted for, too, since they can be subject to abuse.

26. Are blank checks, purchase orders, contract forms, and company securities kept in a safe? _____ Yes _____ No

Any form which can be forged and used to procure cash or materials should be kept in a carefully protected, locked location. Misuse of a form might not be detected for a long time, if ever.

27. Are petty cash transactions kept to a minimum and used only for designated purposes? _____ Yes _____ No

The use of petty cash without restrictions is a bad business practice. Keep petty cash purchases to a minimum and reconcile them against receipts and materials like any other cash transaction.

Section 4
CREDIT MANAGEMENT

28. Do you have a written credit policy, the result of a thorough analysis of the importance of credit transactions in your business? _____ Yes _____ No

The expense of credit may often be accepted by the customer if other parts of the transaction are favorable. Credit and financing arrangements are available which allow the seller to pass on credit transactions to someone else at a fee.

A written policy provides uniformity to protect the business against unwise credit arrangements, and customers know what to expect.

29. Do you know how much credit sales add to your gross income compared to the cost of such additional income? _____ Yes _____ No

It's not an easy question to answer, but financing your customers through credit sales is justifiable only as long as such additional sales produce additional net income at a reasonable rate of return. The owner-manager must be very careful to account for all expenses in such credit sales; otherwise credit customers will be subsidized by those who pay cash or meet standard trade terms.

30. Are all credit accounts reviewed monthly? _____ Yes _____ No

31. Are you firm in pressing for payment on past due accounts? _____ Yes _____ No

32. Do you have a good sense of timing for pressing creditors? _____ Yes _____ No

The owner-manager of most small businesses must devote some time to collecting credit accounts. No manager can afford to be careless in following up collection efforts. The owner-manager is generally in the best position to make sure creditors pay. Repeated contact work and collection experience will help you develop the skills you need to insure prompt payments.

33. Are you the victim of buyers who can't get credit elsewhere? _____ Yes _____ No

No sale is of benefit to your company until it's complete. Many small businesses are the victims of buyers who have exhausted their credit everywhere else and are looking for a new source of financing.

34. Are your trade credit and payment terms enforced strictly but fairly for all customers? _____ Yes _____ No

It's human nature to apply pressure to see just how strictly a policy will be enforced. A seller should establish fair terms and insist they be met by all customers. Giving concessions only leads to trouble later on. A sales that's "right" in the beginning is defensible to completion.

35. Do you hesitate to sue a creditor before writing off a bad account? _____ Yes _____ No

In recent years many states have made it easier to bring action to collect small accounts. A suit to collect isn't bad taste or harassment. Often the threat of such action is sufficient to get what's due you. If not, don't hesitate to pursue a legitimate claim for payment.

Section 5
INVENTORY CONTROL AND MANAGEMENT

36. Have you applied an ABC Analysis to your production inventory? _____ Yes _____ No

ABC Analysis can establish classes for inventory items, because in general: (1) 10% of the part numbers will represent about 75% of inventory investment; (2) a total of 25% (including the previous 10%) of the part numbers make up about 90% of the total investment: (3) and the remaining 75% of the items constitute about 10% of the inventory investment. Control can then be analyzed in terms of dollar value and its impact on total inventory cost.

37. Do you know the total cycle times needed for inventory replacements, particularly for critical items? _____ Yes _____ No

38. Do you apply the principals of Economic Order Quantity (EOQ) to your inventory program? _____ Yes _____ No

Appropriate inventory levels can be approached only by knowing the costs associated with acquisitions and the time value of inventory investment. In general, the correct level of any item is set when it's known how long it takes to receive an order, the rate of use, and the correct order quantity. This is based on the dollar value of the order and the rate of withdrawals for use. Review details of such analysis is an inventory management textbook.

39. Do you have good up-to-date perpetual records for production items, work in progress, and finished goods? _____ Yes _____ No

Perpetual inventory records are necessary in any good system of control. These records may not be absolutely accurate, but should develop running totals necessary for production planning and scheduling. Additions and withdrawals should be posted as promptly as possible or the perpetual records are of little use.

40. Are your physical inventory checks useful to you in analyzing your inventory management? _____ Yes _____ No

Annual physical inventory checks are probably too infrequent for some items. As physical checks are made, the degree of variation from the perpetual records will show you where more frequent checks are desirable. Variations between the perpetual records and the physical count should give you an idea how well each is working. You must make a judgement of how large a discrepancy may be adjusted without a formal report from the inventory manager. Some small shortages can (and should) be written off, but do it conservatively so that the responsible parties don't become careless about maintaining control.

41. Are all requisitions, purchase orders, contract forms, and similar documents kept under tight security until they're used? _____ Yes _____ No

Any original form or record that can be used to procure goods or services shouldn't be freely available. Such documents can be used in unauthorized ways. The most trusted employees may abuse your confidence in them.

42. Are all parts of a purchase transaction carefully checked and reconciled before being closed out? _____ Yes _____ No

A purchase involves many different actions by a variety of people. Typically, requisitions should be compared with the purchase order which in turn is compared against the receiving reports and invoices before a voucher for payment is issued. A lack of tight, effective controls will encourage theft and alteration of records; it will result in an inability to follow up on vendor responsibilities and other kinds of inventory mismanagement.

43. Have you developed realistic costs which enable you to determine reasonable tradeoffs in your inventory programs? _____ Yes _____ No

An individual company may wish to conduct its inventory program in ways unlike those of others in its industry. A stock-out may be tolerated in one company for some items at all times, whereas another firm may desire a high level of probability of no stock-outs. You have to study your records over a period of time before you can make a reasonable judgment on how you should run your program. Until you know the costs, you can't decide which course of action to take based on costs versus benefits.

Section 6
PURCHASING

44. Does your vendor list include mostly firms that sincerely want your business? _____ Yes _____ No

45. Do a number of your vendors perform services for you that are generally not included in a transaction with your competitors? _____ Yes _____ No

46. Do you suspect that some of your vendors don't extend themselves for you because you've become a "loyal" customer? _____ Yes _____ No

Vendors are the most valuable resource a purchasing department can use. Not all vendors are equally beneficial to a company. Buy from firms sincerely interested in your business and its success. To keep your business they'll work hard and often extend themselves for you. In times of stress the buying company can count on these vendors for help to hold a market position that might otherwise be lost.

47. Do you buy largely by specifications, rather than by brand name or simply by accepting what the vendor offers? _____ Yes _____ No

A buyer should generally set specifications and then proceed to secure the products or materials. You can solicit competitive bids and consolidate your requirements by using specifications. If you specify brand names or vendor brands, you may lose buying advantages.

48. Do you make sure you're getting the right quality in your purchases by using "value analysis"? _____ Yes _____ No

The only way you can maintain the proper level of quality is to constantly analyze the quality being bought and determine if it's "right" for the intended purpose. Value is personal, and value analysis should help establish if the quality of your purchases is higher or lower than you need.

49. Do you have more than one source of supply for any critical item? _____ Yes _____ No

50. Do you solicit bids on purchases whenever you are not sure what the price ought to be? _____ Yes _____ No

Use your vendors to increase your options. You can try additional sources, bids, negotiations, and advance commitments to develop buying advantages. Often a direct appeal to a vendor on a particularly difficult problem will bring valuable help.

51. Are most of your purchases made at the "right" price? _____ Yes _____ No

The right price for a buyer depends on the quantity bought, the circumstances of the purchase, and the bargaining position of the buyer. Inability to buy "right" often results from poor planning and preparation by the buyer. Persuasive arguments and effective presentation of the purchase request are the most effective ways to gain an advantageous bargaining position.

52. Are you familiar with the transportation rates for your more important purchases? _____ Yes _____ No

Small business managers often don't know about transportation rates. If a firm has no one who's knowledgeable in this area, it's wise to get advice from a traffic consultant. If a consultant isn't available, the buyer can solicit advice from the traffic department of a rail or truck carrier. Lacking either of these avenues, the buyer should study applicable tariffs and question carriers.

Section 7
PLANT AND EQUIPMENT

53. Have you analyzed plant location and facilities to determine whether or not operations are efficient? _____ Yes _____ No

Features such as plant location, machine placement, material flow, and machine utilization are often not properly recognized as important features of a business operation. Positive effort to improve and maintain these activities is necessary to insure that efficient results are achieved.

54. Are you able to make a sound decision about machine and equipment ownership for manufacture versus purchase of products produced elsewhere? _____ Yes _____ No

Plant and equipment are of value to the enterprise only if they contribute steadily and at a profit to total business operations. Thorough trade-off analysis should be conducted periodically to establish or reestablish the contributions of plant and equipment features.

55. Do you regularly assess the possibility of plant and equipment obsolescence? _____ Yes _____ No

Obsolescence is not a circumstance that can be handled by the ordinary recovery through depreciation expense. It may occur without warning or develop so insidiously that the owner isn't aware of what's happening. Review plant and equipment frequently for impending obsolescence.

56. Have you conducted a "facilities-mix" analysis for your firm? _____ Yes _____ No

An analysis of facilities-mix is concerned with the relative proportion of machines of varying degrees of sophistication which are appropriate for a firm. Various combinations are explored to determine possible changes that might be desirable in the short or long run.

57. Do you maintain thorough lifetime records on accumulated costs for all plant and equipment features? _____ Yes _____ No

Investment in plant and equipment is a major cost for a manufacturing firm. No firm can depend entirely on supplies or other users for determining total costs during the lifetime of an item. Your own data is invaluable in planning for future investments.

58. Have you developed data for considering the possibilities of plant and equipment failures and their costs? _____ Yes _____ No

No production entity is any better than its weakest link. Analysis should be run to determine potential bottlenecks and failures and the costs of correcting or preventing them.

59. Do you know the importance of plant and equipment in the overall success of your firm? _____ Yes _____ No

Your plant facilities and equipment may or may not be significant in your firm's success. Some effort should be made periodically to determine just how significant these features are. If they do contribute substantially to your success, you may want to determine if such an advantage might be lost if they could be copied by another firm.

Section 8
PRICING

60. Are your prices competitive based on the quality and service that go with each product sold? _____ Yes _____ No

61. Do you know what part service plays in making a sale? _____ Yes _____ No

A smaller business must constantly work to overcome the advantages enjoyed by large businesses. To work around these advantages, the small business manager should attempt to enhance the worth of his product to the customer. This often can be accomplished by offering a greater package value and by analyzing service factors to estimate how the customer values it as part of the price.

62. Do you generally attempt to "sell around" the prices of a larger competitor instead of meeting those prices head-on? _____ Yes _____ No

The small business manager has many options in developing sales packages. Often you may be able to negotiate an adjustment to a difficult sale condition or achieve a valuable trade-off. Many of the things that appeal to a buyer may not cost much except special effort on your part. These are areas in which small business has advantages.

63. Are there economics of scale in your operation which enable you to sell lower priced production quantities? _____ Yes _____ No

Large firms often won't make short quantity or specialized production runs. Technical capabilities may be equal, but overhead may be so high in the larger firm that the smaller firm will always have a cost—and thus a selling price—advantage.

64. Do you use break-even analysis in computing costs for price setting? _____ Yes _____ No

Break-even analysis is essential in determining costs at various levels of output. From this data the producer can assign various sale prices and determine what profit margins are possible. Every small business manager should develop the ability to compute break-even quickly and from that make pricing decisions.

65. Have you developed a pricing strategy which allows you to adjust prices to meet competitive situations as they develop? _____ Yes _____ No

Pricing strategies are developed to allow a business to change prices to meet opportunities and challenges as they arise. Some of these result from customer pressures, but most come from the action of competitors. You should always plan for such contingencies—decisions made under pressure are more likely to be wrong.

66. Do you attempt to insure that the price charged represents a "fair value" to nearly all your customers? _____ Yes _____ No

No seller can satisfy everyone, but each should try to satisfy the majority of customers. A price is always relative to an assortment of features which have different buyers. An ability to sense what the customer wants or expects is one basis on which the seller should set prices. This is particularly important for manufactured products because buyers look at all features of them and probably do a good bit of careful comparison shopping among available choices.

CHAPTER FOUR

PLANNING AND OPERATIONALIZING CORPORATION X

Establishing A Corporate Entity Using An Entrepreneurial Approach: An Example

The best way to illustrate the use of an entrepreneurial approach for establishing an enterprise is to illustrate the concept with an example...a case history. The case of "Corporation X" is such an example. Readers are cautioned, however, that this example should not be considered a "model" in the traditional sense of the word. It is only to be used as a "process" example. Thus, your organizational manifestation that uses this process may have quite a different corporate structure and/or identity.

Corporation X (later called MN. P.A.C.) was the first "identity" given to Minnesota Diversified Industries' (MDI) (St. Paul, Minnesota) first entrepreneurial enterprise. The organizational structure was intentionally designed to test the hypothesis that advantages do exist in the use of the for-profit corporate model to deliver employment opportunities for persons with disabilities. The testing of this hypothesis could answer some of the concerns coming into focus during the resurgence in field interest in the use of community-based employment (CBE) service delivery programs.

Referring to the focus of community-based employment as "resurgent" is premised on the fact that MDI operated a large community-based employment program from 1968 to 1973. The program was designed to place and train persons with disabilities using on-site instructors working in cooperation with plant management at six major Minnesota corporations. The model had been adapted from one developed in England, where it had been in popular use from 1962 to 1965.

The elements of the community-based program that led to the creation of Corporation X following detailed exploration of a new model included those in Figure 15 below:

FIGURE 15

1. Most placements were made to positions providing little or no employer-sponsored benefits (vacation, paid holidays, sick leave, medical insurance, or retirement for CBE).

2. Many of the placements were for part-time jobs, ranging from 4 to 20 hours per week, and usually represented a reduction in annual earnings for those in CBE.

3. Most placements were made in a single industry, the service industry; little opportunity existed for service consumers to express their preference for occupations in CBE.

4. Nearly all placements provided improved opportunities for the service consumer to interact with non-disabled co-workers while participating in CBE.

5. Little evidence was found that significant social interaction between handicapped and non-disabled workers occurred after, or outside of work.

6. An exceptionally high "burn out" rate found among field trainers, probably due to the professional isolation they experienced in CBE, was a reoccurring problem.

7. The average annual cost to taxpayers for each community-based employment placement was over $8,000 (when serving other than the most able) compared with $2,900 for traditional sheltered programs.

A re-examination of all in-house programs at MDI (sheltered workshop, work activity center, and work components of Developmental Achievement Centers) was undertaken at the same time that CBE programs were analyzed. During this review, some common trends and concerns were identified. The implications of these identified trends and concerns eventually had considerable impact on the design of Corporation X—during the planning and developmental stages. The trends and concerns identified included those found in Figure 16 below:

FIGURE 16

1. Little opportunity existed for peer modeling to occur in these in-house programs because the work-force was segregated—embodied entirely by persons with disabilities.

2. The production centers that fed these in-house programs continuously experienced low annual earnings and extremely competitive bidding situations because the entire work-force was composed of a single disability group. This resulted in a narrow band of market potential (low skill).

3. Vesting of the accumulated assets of the in-house programs, based on the labors of the disabled workers employed by the programs, was effectively denied to those workers, the workers who produced the asset. (When a not-for-profit entity goes out of business, all remaining assets are turned over to the state general fund or to an organization formed for the same purpose.)

4. Persons with disabilities never have the opportunity to gain enterprise ownership. (Strong evidence exists that worker ownership is important to the operation of a business.) The application of enterprise ownership concepts to the remediation of workers with disabilities may have therapeutic and pragmatic value. Many workers with disabilities form exceedingly strong ties to objects, people, or entities. Perhaps a worker will treasure a new jacket and refuse to leave the jacket in a locker, insisting on keeping it in sight during the workday. The value of a five- or ten-year service pin should not be underestimated. How many other motivating factors may be found that are as compelling as enterprise ownership?

5. Most programs were structured in a manner that puts staff in a superior role in all client/staff relationships.

6. There is a reluctance by venture capitalists and commercial lending institutions to make resources available to launch viable businesses that predominately hire workers with disabilities.

7. The lack of skilled craft and technical personnel exists, barring many organizations from fields that have demonstrated growth potential equal to the service occupation.

8. There is reluctance on the part of some foundations to fund in-house programs because consumer and advocacy groups are lobbying against their existence.

9. State governments shift most of their resources to community-based programs without studying the impact of these major shifts on individuals now being served by in-house employment programs.

Deciding to Change

The first major decision, in a series of major decisions, was to determine the type of entity that would be created. For Corporation X, the decision made by the MDI board was to develop an entity that would be operated as a wholly owned subsidiary of MDI. Other alternatives existed, including the creation of a completely separate, new enterprise. The subsidiary approach was chosen because it could provide Corporation X management ready access to start-up funding and management resources.

Because any operating design involved the imposition of a set of operational parameters, the MDI board also drafted

a list of factors that would be need to be incorporated into the design of a wholly owned subsidiary. These factors included those found in Figure 17 below:

FIGURE 17

1. To be judged a successful venture after a reasonable start-up period, Corporation X would have to be profitable.

2. The organizational structure must provide an opportunity for all classes of employees (i.e., hourly and salaried, exempt and non-exempt) to gain enterprise ownership.

3. Employees must earn ownership in the enterprise; they must have no opportunity to introduce non-Corporation X income into the purchase of stock.

4. All stock issued to employees must exist only as "phantom" shares having no street value. Thus the stock would have no cash value and could not be traded publicly. Its only value was vested in its sale back to Corporation X—upon the employee's retirement or termination.

5. Corporate board seats must be elected positions, with the number of outstanding shares owned by each voter or voting block equal to the number of votes that may be cast for each seat.

6. The work-force must provide employment for four major groups of potential workers: persons who are retired and in need of a supplemental income, persons with disabilities, skilled and technically qualified model workers, and persons living below the poverty level. The right mix of these worker groups was seen as critical to the assurance of a dynamic work-force with the desired skill and flexibility (probably essential to the success of the venture.)

7. The corporation must enter business sectors or segments in which no other local sheltered workshop or prison industry was engaged. (The first market focus chosen was the operation of a distribution center capable of handling the national distribution of Litton Industries microwave cookware. This marketing plan included a move into the operation of a foreign trade zone or a sub-zone of a foreign trade zone. Retail store chains were the target customers.)

8. The need for capital must be minimized. The leasing of a building (no tax advantage exists in ownership because we would be for-profit) and all major equipment required was part of the capital limitation strategy, as was the use of service contracts for such things as payroll and accounting services, transportation services, and employee support programs.

Organizing An Implementation Plan Task Force

The next major task for the MDI board was the organization of a task force to create an implementation plan for Corporation X, paying strict attention to the operating parameters listed above. This team was made up of the following officers from MDI: Three Board members, President, Vice President of Operations, Vice President of Sales and Marketing, Director of Human Resources, and Controller. Two strategic planners, on "loan" from First Bank System (a locally operated regional bank), and an attorney specializing in corporate law completed the team.

The MDI board first charged the task force with addressing each of the concerns that surfaced during the review of MDI programs, especially the operation of the CBE model. The task force responded by first discussing the compiled data and determining the issues and responses that would influence the organization and operation of Corporation X. Five areas were discussed. They were: the need for employer-sponsored benefits; the need for full-time employment to increase earning power; the need for additional vocational opportunities; the need to improve opportunities to model and to interact with non-handicapped co-workers; the need to provide the opportunity for social interaction; the effect on trainers; cost and containment. Summaries of the discussions for each area are provided below.

The need for employer-sponsored benefits

The task force first identified the primary fringe benefits provided, at least in part, by nearly all employers to most of their workers found in Figure 18 below:

FIGURE 18

1. Paid vacation
2. Paid holidays
3. Sick leave
4. Medical insurance
5. Profit sharing

Secondary benefits (provided by some employers to some of their workers) were also identified. They included those found in Figure 19.

FIGURE 19

1. Disability insurance (separate from legally required workmen's compensation)
2. Dental care
3. Retirement program
4. Life insurance
5. Child care
6. Continuing education program

In the discussion that followed, the task force came to the conclusion that during the first two years of operation, Corporation X would provide only the five primary benefits to all workers. However, secondary benefits would be added after two years of operations if sufficient resources were available at that time.

The need for full-time employment to increase earning power

After reviewing the alternatives, the task force decided to establish a standard work week of 40 hours. However, provisions would be made for workers who would benefit from shortened work weeks. It was thought that these workers would include older workers who needed to supplement their retirement, and/or other workers who would need to participate in job sharing to avoid earnings in excess of benefit caps imposed by service provision agencies. Further discussion led to the recommendation that at least some workers would be hired (during the start-up phase of the operation) to work part-time. This would reduce the risk of lay-offs as the staffing patterns for the new enterprise were established. These part-time workers would be chosen on the basis of their need and/or desire to cap their earning potentials. At the outset, they would work on an on-call basis.

The need for additional vocational opportunities

The very nature of the proposed products for Corporation X (distribution, import/export, and warehousing) provided a departure from the fast food and hospitality industry service job training that was provided at that time. In addition, the task force recommended that the new organization take advantage of every possible alternative to insure that a variety of training and/or employment opportunities was provided in every job class.

The need to improve opportunities to model and to interact with non-handicapped co-workers

The task force determined that (by design) the work force would contain a mix of workers. This would allow the work force to provide opportunities for non-handicapped workers to serve as models for disabled and/or disenfranchised workers. The work force maximum for persons with handicaps was set at 30 percent, 20 percent less than the maximum recommended for affirmative industries. (There will be more discussion of this issue when the issue of governance and

ownership transfer through profit sharing and Employee Stock Ownership Plans are considered.) The task force further set a minimum work force requirement of 30 percent for non-handicapped model workers. Thus, at least a one-on-one apprenticeship program for individuals with handicaps was established. The remained workers would be older workers or persons who were otherwise vocationally disenfranchised.

The need to provide the opportunity for social interaction

The lack of social interaction between non-handicapped individuals and individuals with handicaps seems to defy any direct intervention. The task force decided that, in the best interests of all Corporation X workers, the organization would create an environment that would support interaction without expecting a certain level or type of interaction to be achieved.

The effect on trainers

Although no internal demand for on-site trainers would be experienced using the Corporation X structure, the task force did anticipate that some of the individuals with handicaps would be placed at Corporation X through MDI's community-based program. The managers of Corporation X would be encouraged to help the community-based trainers feel like part of the Corporation X team. Managers would also be expected to put forth every effort to insure that the trainers also maintained strong ties to other site trainers at MDI. They would allow the trainers time to attend staff inservice and regular Human Resource Department meetings.

The need for cost containment

The task force was concerned about the cost of community-based programs in relation to in-house programs. CBE costs are known to be almost three times as expensive as their sheltered counterparts. By design, an element of cost efficiency could be built into the Corporation X structure. The on-site trainer could be made more productive if the managers of Corporation X provided current individual-specific production data on a regular basis. This would allow the on-site trainer to target training resources and efforts to those problems directly related to productivity. With greater efficiency, the on-site trainer could be expected to work effectively with up to eight workers with handicaps. The task force estimated that this concentration, eight worker/trainees per trainer per site, would reduce the per-individual cost for CBE from a high of $8,000 (being experienced at that time) to a new range of approximately $4,300 to $5,500.

Factors To Be Studied And Incorporated Into An Operational Plan

After the task force had examined the issues and set in place most of the operating parameters for Corporation X, the MDI board charged the committee with the development of an operational plan.

The task force first had to establish the legal framework for Corporation X to operate as a recognized subsidiary of MDI. It could be legally formed as a 501(c)3 corporation, a co-op, an Employee Stock Ownership Plan (ESOP) corporation, or some other recognized entity.

The task force considered many factors as the members deliberated their recommendation for a legal foundation. These factors included those found in Figure 20 below:

FIGURE 20

1. The organization's future need for capital
2. Tax benefit to givers when contributing to nonprofit
3. Under a co-op or ESOP employees would have to be willing to forego short term profit taking to ensure present and future capital needs were met.
4. Potential difficulty in establishing credit worthiness with commercial leaders based on ownership by employees.

These factors were applied to each type of legal structure under investigation. Both the ESOP and the Co-op structures were investigated in depth.

If an ESOP were to be chosen as the legal structure, the conditions listed in Figure 21 below would need to be incorporated into the Corporation X operating plan.

FIGURE 21

1. Employees must be allowed to purchase shares during any given year at a rate set three months before the start of each year. Purchasing option changes could not be made during that year.

2. A block of stock must be distributed annually to the employees based on their contribution to the corporate effort. This distribution must be a bonus, provided at no additional cost to the employers.

3. When employees are terminated, retire, or die, all of their shares must be sold back to Corporation X at a value equal to the current net worth of the Corporation divided by the total number of outstanding shares.

4. No employee may own more than 10 percent of the total number of outstanding shares.

If a co-op were to be chosen as the legal structure, the conditions listed in Figure 22 below would need to be incorporated into the Corporation X operating plan.

FIGURE 22

1. Every employee is required to invest $1,500 in the co-op during the first 36 months of employment.

2. In all cases where investing $1,500 would be an undue hardship on the employee, the amount of investment must be equal to a minimum of 5 percent of net earnings over any time period needed until the $1,500 level was met.

3. Only vested employees (those having met the $1,500 minimum) may have a vote on the percentage of net earnings to be distributed as profit share.

4. On all other matters, each employee would have an equal vote.

The task force recommended to the MDI board that the Employee Stock Ownership Plan be chosen as the legal operating platform for Corporation X. It then moved on to complete the operating plan.

To minimize the need for venture capital, the task force recommended that Corporation X adhere to the guidelines listed in Figure 23 below:

FIGURE 23

1. Lease its physical plant and all major equipment.

2. Acquire all other equipment through surplus sources, including fixtures, furniture, and tools from the surplus stores of other Minnesota corporations.

3. Establish a fifteen-day net credit policy.

4. Request during all contract negotiation proceedings that all materials to be used in sub-contract operations be provided by the prime contractor.

5. Insist that Corporation X not become involved in proprietary products until the financial status of the enterprise and/or market conditions indicate that a reassessment of this position is warranted.

The task force recognized that financial projections will be a key in the accumulation of required capital for the new enterprise. Therefore, the task force recommended a strategy that would insure that all needed projections are obtained. The first of these projections should be initially generated through a supplemental monthly statement. This was possible because the original business base for Corporation X was comprised of contracts already being performed by MDI. Each supplemental monthly statement must identify the items listed in Figure 24 below.

FIGURE 24

1. Estimated venture capital required.
2. Actual working capital required.
3. Any additional capital needed to service debt that has been accumulated during start-up.
4. A projection of the level of unit sales required to sustain operations.
5. The value of the labor needed to produce goods and/or provide services as presently provided and relative to the local and national labor markets.
6. Any and all current ratios.
7. Ratios of direct labor to sales on a valued-added basis.

Now the task force became very specific. It used its best intelligence reports to actually flush out an "opening day" operating plan with manpower requirements; likely contracted services; the physical plant required, including space utilization within the facility and needed modifications and renovations to the facility; the initial manufacturing and service bases; and the equipment and furnishings needed to begin operations. Some of the specific recommendations for Corporation X are listed in Figure 25 below.

FIGURE 25

Manpower

50%	President/Sales & Marketing
100%	Foreman
100%	Two Lead workers
10%-100%	Factory workers as needed—handicapped individuals referred by MDI
100%	Secretary/Clerk

Contracted Services

Type of service	Source	Conditions
Phone Answering Service	Bid	monthly charge
Accounting Service	MDI	monthly charge
Payroll Service	MDI	monthly charge
Audit	Bid	contract hourly
Transportation	MDI/other	contract hourly
Building Maintenance	MDI	hourly charge
Development and Planning	MDI	hourly charge

Facility

90,000 sq. ft. Midway area annual lease

Space Utilization

60,000 sq. ft.	Litton distribution
1,200 sq. ft.	Office and lunch room
1,000 sq. ft.	Service area
27,800 sq. ft.	Contract development

Modification/Renovation

Paint ceilings, 3 floors
Replace lighting on 1st floor
Modify present office area for lunch room/office area
Other work specific to contract requirements

Initial Business Base

Litton—distribution, warehousing, and packaging
Off-site cleaning service
Box and carton fabrication
Macrolite products

Equipment and furniture needed

Forklifts (Source—Litton)	File cabinets
Pallet jacks	Portable safe
Conveyors	Microwave oven
Table and stools (work stations)	Refrigerator
Lunch room table and chairs	Trash bins
Time clocks and racks	Vending machines
Bulletin boards	Lockers
Fire extinguishers	Copy Machine
Desks and chairs	Light fixtures

Implementation Plan and Schedule

Now that the task force had provided the MDI board with a "snap-shot" of the Corporation X enterprise by developing an operations plan, the board must charge the task force with putting together an implementation plan. Actually, several plans (or at least several forms of the plan) will need to be developed.

First, the task force created an Implementation Detail Plan that listed all phases of the enterprise development and the activities that needed to be completed at each step. This plan (Figure 26) begins on page 45.

Second, the task force illustrated the implementation plan by creating an Implementation Plan and Schedule that showed the months when each step would be completed. This schedule (Figure 27) is found on page 52 below.

Finally, the task force developed a working document that would help the board of directors track the implementation of the new enterprise. This took the form of a checklist. The Implementation Checklist for Corporation X (Figure 28) is found on page 52.

FIGURE 26

The implementation detail plan

1. Design evaluation criteria for Phase I

   1.1 Units of service provided

   1.2 Level of business attained

   1.3 Level of subsidy required (non-public but not earned)*

   1.4 Decreases in level of public assistance required by participants

   1.5 Number of participants that have new work skills

   1.6 Profitability achieved at 12 months, 24 months, and 36 months

   1A.1 First draft of budget and cash flow demand for planning and start up
   (*There are many subsidies paid to farmers and other enterprises that are for-profit.)

   - Completed by 3rd week of Phase I

2. Develop business plan

   2.1 Review potential capital resources amount and source

   2.2 Review other supplemental resources

   2.3 Conduct a marketing survey of un-met needs in target area business community

   2.4 Select three major prospects for feasibility study

   2.5 Make a financial analysis of prospect opportunities

   2.6 Work opportunities of prospect opportunities

   2.7 Design implementation plan and schedule

   2.8 Prepare second draft of budget and cash flow demand

   2.9 Acquire initial funding for start up

3. Recruit board of directors

   3.1 Identify function of board of directors

   3.2 Determine optimum size

   3.3 Identify prospects

   3.4 Interview prospects

3.5 Select three key members who will recruit others (If you have chosen to work as an individual entrepreneur, skip 3 and 4, look in the mirror and see if you have the right stuff.)

4. Recruit and hire CEO

4.1 Develop job description and salary range

4.2 Post and advertise position

4.3 Screen applicants and conduct final interview

4.4 Execute performance contract with C.E.O.

- Completed by 8th week of Phase I

5. Conduct inservice training for board and CEO

5.1 Perceptions and expectations of persons with special needs

5.2 The entrepreneurial model in the delivery of social service

5.3 Corporate goals and objectives

5.4 Evaluation process and procedures

5.5 Responsibility and duties of board and CEO

5.6 Complementary relationships of board and CEO

5.7 Third budget draft and cash flow demand

- Completed by 10th week of project

6. Prepare corporate policy manual

6.1 Criteria for acceptance of program participants and employees

6.2 Criteria for placement, transfer, or termination

6.3 Grievance procedures

6.4 Attendance and absenteeism

6.5 Affirmative action

6.6 Benefits and wages and employee review

6.7 Procedure for change of policy

6.8 Company rules (i.e., dress code, company property, and safety)

6.9 Demotion and discipline

- Completed by 10th week of Phase I

7. Confirmation of site suitable for project location

   7.1 List assumptions for selection criteria

   7.2 Define geographic and physical needs

   7.3 Determine budget for physical plant

   7.4 Compile a list of suitable sites

   7.5 Draft lease of other contract considerations

   - Completed by 8th week of Phase I

8. Identify potential participants

   8.1 Draft and release public information bulletin

   8.2 Implement speakers bureau

   8.3 Notify other service agencies serving similar populations and geographic area

   8.4 Compile log of requests for information or services

   - Completed by 13th week of Phase I

9. Select companies for first sales effort

   9.1 Review initial interview data from marketing report

   9.2 Review additional information generated from public information releases

   9.3 Develop desired contract characteristics and corporate impact statements

   9.4 Develop shop rates and break-even point

   9.5 Begin to negotiate and bid desirable contracts

   - Completed by 32nd week of project

10. Design management structure

   10.1 Review business plan and modify as required

   10.2 Review corporate mission statement

   10.3 Survey technical resources available on a purchase of service basis and cost

   10.4 Develop employee management model and cost

   10.5 Evaluate and select combination of purchase of service and employee provided management to be used

   10.6 Prepare management plan

11. Arrange for permanent financing

    11.1 Investors deposit

    11.2 Bank loans

    11.3 Venture capital fund

12. Recruit management team and technicians and execute service contracts

    12.1 Prepare draft contracts for purchase of service

    12.2 Complete job description

    12.3 Evaluate for appropriate interface

    12.4 Screen, select, and execute contracts

    12.5 Screen, select, and hire needed employees

    - Completed by 16th week of Phase I

13. Conduct inservice training for management team

    13.1 Corporate goals and objectives

    13.2 Team building

    13.3 Perceptions and expectations of individuals with special needs

    13.4 The entrepreneurial model in the delivery of social services and ESOP programs

14. Negotiate and execute lease for space required

    14.1 Review by legal counsel

    14.2 Review by board

    14.3 Modify

    14.3 Execute

    - Completed by 20th week of Phase I

15. Renovate plant

    15.1 Develop budget for project and modify annual budget

    15.2 Plans and specifications

    15.3 Bids requested

    15.4 Contracts awarded

15.5 Renovation completed

- Completed by 25th week of Phase I

16. Purchase equipment

16.1 Plant inspection by management to review safety and environmental factors

16.2 Design and post evacuation plans

16.3 Review all signing to make sure it is adequate

16.4 Review production flow and space allocation

- Completed by 29th week of Phase I

17. Ready plant for operations

17.1 Plant inspection by management to review safety and environmental factors

17.2 Design and post evacuation plans

17.3 Review all signing to make sure it is adequate

17.4 Review production flow and space allocation

- Completed by 29th week of Phase I

18. Recruit and hire five lead workers

18.1 Post and publicly announce position

18.2 Verify work record and job credentials

18.3 Select most appropriate, based on work to be done

18.4 Arrange for employee support services by outside vendor

- Completed by 30th week of Phase I

19. Conduct inservice training for lead workers

19.1 The entrepreneurial model and ESOP

19.2 Corporate goals, objectives, and policies

19.3 Perceptions and expectations of persons with special needs

19.4 Expectations and responsibilities for lead workers

19.5 Administrative structure and employee review

- Completed by 31st week of Phase I

20. Begin production

    20.1 Review and instruct employees of production schedule committed to

    20.2 Review employee profiles and make assignments

    20.3 Review and instruct employees on quality control standards for product or services to be provided

    20.4 Communicate job standards to employees

    - Completed by 32nd week of Phase I

21. Recruit, select, and begin intake of program participants

    21.1 Complete individual profiles on applicants

    21.2 Verify availability of support services needed to be employed

    21.3 Select on basis of project criteria

    21.4 Repeat steps 18 to 20 in total

    - Completed by 45th week of Phase I

22. Arrange for necessary support services required by program participants

    22.1 Match individual needs as per individual profile with support services identified

    22.2 Review appropriateness and accessibility for each participant

    22.3 Request modification when required

    - Completed by 45th week of Phase I

23. Expand sales effort to support Phase II

    23.1 Determine volume required to employ 30 individuals

    23.2 Prepare sales goals and incentives

    23.3 Arrange plant tour by potential customers

    23.4 Arrange luncheon meeting with corporate CEO, board members, and potential customers

24. Design community placement system

    24.1 Determine criteria to judge participant in need of alternative employment

    24.2 Identify community resources to be used

    24.3 Review resources for appropriateness and accessibility

    24.4 Determine criteria for successful change in employment

    - Completed by 50th week of Phase I

25. Add program participants as needed

    25.1 Review production schedule for manpower requirements

    25.2 Analyze production schedule for required mix of manpower

    25.3 Repeat step 20

    - No completion date—ongoing

26. Evaluate Phase I and design criteria for Phase II

    26.1 Review Phase I evaluation criteria to design methodology for project evaluation

    26.2 Determine if outside or internal personnel will conduct evaluation

    26.3 Conduct training sessions for persons to evaluate project

    26.4 Review findings

    26.5 Modify implementation plan for Phase II

    - Completed by 48th week of Phase I

27. Begin Phase II

Although you are not likely to develop a plan with this detail and proceed from step 1.1 to 27 without some modifications during implementation, you should feel the responsibility for doing so. If you cannot review the plan presented and modify it to fit your specific circumstance, you are probably not ready to start your enterprise.

At this point, the task force was ready to provide a second level of detail. This level involves establishing some time frame parameters to put the implementation plan into physical perspective. The Implementation Plan and Schedule is found in Figure 27 on page 52.

The final permeation for the implementation plan takes the shape of a checklist that incorporates all the plan elements, the assignment of responsibility for completing each element, and the dates that each element is begun and completed. This tool helps the board track the progress of implementation.

The Implementation Plan for Corporation X (Figure 28) illustrates the way in which these implementation plans and schedules may be integrated. Remember that the model referred to as Corporation X is presented as an illustration for the use of the entrepreneurial process, not as the model. If it were possible to define the model, then entrepreneurial approach would lose its value. Corporation X is an example of what can be accomplished using the entrepreneurial concept. If anyone ever promises you the entrepreneurial model, I suggest you turn to someone else more willing to assist you in reaching a clear understanding of the concept.

FIGURE 27

IMPLEMENTATION PLAN AND SCHEDULE

PHASE I	TIME IN MONTHS	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Design evaluation criteria for Phase I		x													
2. Develop business plan		x	—	—	—	—	—	—	—	—	x				
3. Recruit and hire CEO		x	—	x											
4. Recruit board of directors			x												
5. Conduct inservice training for board and CEO			x												
6. Prepare corporate policy manual			x	—	x										
7. Confirm buildings available for project		x	—	x											
8. Identify potential participants		x	—	—	—	x									
9. Select company for first sales efforts		x	—	—	—	x									
10. Design management structure			x	—	x										
11. Arrange for permanent financing				x	—	—	—	—	x						
12. Recruit management				x	—	x									
13. Conduct inservice training for management team					x	—	x								
14. Negotiate lease					x	—	x								
15. Renovate plant					x	—	—	x							
16. Purchase equipment						x	—	—	—	x					
17. Ready plant for production								x							
18. Recruit and hire five lead workers								x	—	x					
19. Conduct inservice training for lead workers								x	—	—	x				
20. Begin production								x	—	—	—	—	—		
21. Recruit five participants & develop individual profile									x	—	—	—	x		
22. Arrange for necessary support services									x	—	—	—	—		
23. Expand sales efforts for Phase II									x	—	—	—	—		
24. Design community placement system										x	—	—	x		
25. Add program participants as needed										x	—	—	—		
26. Evaluate Phase I and design criteria for Phase II												x	—		
27. Begin Phase II														x	—

FIGURE 28

Implementation Checklist for Corporation X

	Phase I	Assigned Responsibility	Start Date	Completion Date
1.	Develop preliminary plan	J. DuRand	05/20/87	
2.	Review preliminary plan	Mgmt. Team		
3.	Establish implementation team (I Team)	Mgmt. Team		
	a) function			
	b) membership			
	c) reporting			

4.	Develop mission statement a) goals and objectives b) method for measurement of attainment of goals and objectives	Mgmt. Team		
5.	Develop implementation plan	I Team		
	a) legal review	E. Trousdale		
	b) identify markets to be served	I Team		
	c) manpower requirements	I Team		
	d) develop supporting contracts	I Team		
	e) identify resources required	I Team		
	f) identify potential sources for capital	B. Holman		
6.	Review first draft of implementation plan	Mgmt. Team		
7.	Revise first draft of implementation plan	I Team		
8.	Review second draft of implementation plan	LRSP Comm.		
9.	Revise second draft	I Team		
10.	Recommended final implementation plan			
	a) final draft prepared	B. Holman	08/14/87	08/17/87
	b) mailed to board	B. Holman	08/17/87	08/17/87
	c) schedule information meetings with individual board members	J. DuRand	08/18/87	08/17/87

Phase II	Assigned Responsibility	Start Date	Completion Date
1. Board resolution authorizing creation of Corporation X	Board of Dir.	08/21/87	08/21/87
a) creation of board of directors or board of advisors dependent on model selected	Board of Dir.		
b) file necessary documents with state and federal government	E. Trousdale		
2. President of Corporation X assumes responsibility for all activities.			

a) advisory committee formed	President	
b) annual budget	President	
c) accumulation of required resources	President	
d) design required monitoring systems	President	
e) recruit and hire required work force	President	
f) execute necessary support contracts	President	
g) execute sublease on facility	President	
3. Operations begin	President	
a) review imple-mentationplan for possible required revisions	President	

Phase III	Assigned Responsibility	Start Date	Completion Date
1. Document major events and accumulate information and data	MDI		
2. Publish results for possible replication	MDI		

Employee Stock Ownership Plan

The task force decision to develop Corporation X using an employee stock ownership plan structure (which allowed MDI to effect a transfer ownership to the Corporation X employees) was made following a John Hawthorne seminar that a task force member attended. At that seminar, Hawthorne effectively provided the reasons (found in Figure 29) that the ESOP structure was selected:

FIGURE 29

- An ESOP provides an ongoing market for your closely-held company stock.
- The sale of controlling interest stock to the ESOP may be contained so that control of the corporation is retained by the organizing entity to insure that the interests of the least able employees are fairly represented.
- The ESOP structure allows capital gains tax to be deferred indefinitely, with tax-free rollover to replacement securities.
- Capital funds for use by the ESOP entity may be obtained at market rate interest or below at a time when employees would find it beneficial to their futures.
- ESOP debt, both interest and principal repayments, is deductible for tax purposes.

- The dividend payment on stock owned by the ESOP is deductible for tax purposes.
- An ESOP enterprise can be shown to increase employee motivation and productivity through equity participation.

A major theme in the discussion of the advantages in the use of the ESOP structure, is the reduction of tax liability. Readers should note that neither MDI nor Corporation X in ahy way attempted or will attempt to avoid taxes. All persons and entities involved recognize that payment of each entity's fair share of taxes is essential to ethical management. However, the major reason that this enterprise was brought into existence was to economically empower the employees of the organization. To assure that empowerment is accomplished to its fullest possible extent, Corporation X managers must take full advantage of all legal methods to minimize the taxes paid by the enterprise. This is simply an exercise in the application of good business practices.

Phantom stock

The ESOP concept includes the issuance of stock to employees. This stock, however, is not the same as the "over-the-counter" variety found on Wall Street. All stock issued by the corporation is actually "phantom stock". This is stock that has no street value. The holder of phantom stock has an interest in the enterprise only if the stock has actually been issued to the holder. To obtain any cash value, the stock must actually be sold back to the enterprise. In addition, this sale of all stock held may be only initiated upon the employee's retirement or termination.

These ownership and sale requirements were imposed as the result of the task force's perceived need for Corporation X managers to maintain control of the enterprise. Perhaps that desire for control is really a hold-over from the thinking processes inherent in not-for-profit operations. If only phantom stock is issued, all other persons, such as venture capitalists, are locked out the venture. This also blocks any potential attempt by the employees to sell their interests in the corporation to outside interests at prices higher than actual value.

The task force recognized that future discussion regarding the issuance, sale, and trading of phantom stock deserves more attention. This is especially true in light of the fact that the entrepreneurial enterprise was formed primarily to benefit its employees. Other potential economic gains from the issue of common stock for employees may eventually overcome the organization's need for control. Several other issues may be of secondary interest (i.e., reduced tax burden for society or service to local industry) for the Corporation X ESOP structure.

Ownership as a model focus

"The key to America's future is not cheap labor, but more productive labor."—I.T.

Many writers discussing productivity in American businesses have pointed to ownership as the proven key ingredient to the improvement of individual and corporate productivity. These experts have said that the positive ownership/productivity coupling holds true if a person or corporation is pursuing an idea or a work task.

Ownership in employment

An article in the August 11, 1987, Wall Street Journal reported a 4 percent average increase in performance by firms with an ESOP program over all other firms. Only 2 percent of the firms implementing an ESOP program were in financial difficulty at the time they started their ESOP program. This is really a critical point. It is a common belief that ESOP programs are implemented as a "last resort" by desperate mangers in an attempt to bring their corporation out of a period marked by severe financial difficulties. This article refuted that belief.

Ownership in housing

In a large public housing unit in the Eastern part of the U.S., tenants organized themselves through the energy and effort of one unsatisfied tenant. They created a Tenant Association for the housing units. This association of tenants

established ownership in their housing unit, taking control of the buildings and driving out drug dealers, pimps and others who had preyed on them for many years.

These associated owners implemented a tenants' code to which all tenants were required to strictly adhere. The result of their ownership and effort was a clean, safe, well-kept public housing unit that each resident was responsible for maintaining. Now the residents could direct their resources to improve, rather than maintain, unacceptable conditions.

Ownership in education

Effective teachers establish learner ownership for all learning situations. The teacher wants the learners to understand that they are not working for the teacher's improvement but for their own improvement. Ownership in the learning setting provides a motivational "push" that helps learners achieve task and concept mastery. What these learners achieve walks out the door and into the work place as theirs to keep. Thus, ownership affects each learner's ability to tap his/her potential and build a future.

The role of work in ownership

Every reader, with a little reflection, is likely to recall everyday examples where he/she has seen ownership affecting performance. At its most basic level, ownership probably even affected the care you gave to your first fishing rod or your first bike. Ownership was the key to how you cared for the object because of its perceived value.

Perceptions of value and ownership are also affected by the way in which the ownership was acquired. If that bike or fishing rod were given to you (as were many other items during that period), it is likely to have been perceived as having a lesser value than if ownership was attained through your hard work. Through the expenditure of effort (either directly or indirectly attributed to work), the ownership takes on aspects that are of perceived and tangible value, the ownership becomes real.

Elements of ownership

The idea of ownership seems simplistic on the surface. On reflection, however, the complexities of ownership may become apparent. To design an effective program, consideration must first be given to the needs of the individual then to the need of the enterprise. An analysis of these needs is likely to include the items found in Figure 30 below:

FIGURE 30

Individual Needs	Method of Providing
• Potential for increase in present earnings	Profit sharing
• Potential for increase in net worth	ESOP
• Input into the decision-making process	Employee council representation on board
• Secure future	Positive performance of the enterprise resulting from exceptional individual performance
• Elevated social position	Direct identity with positive performance of the enterprise (public relations)

• Potential for future	Effective performance and growth of the whole unit
Firm's Needs	Method of Providing
• Effective leadership	Appointment based on performance
• Realistic goals and objectives	Board of directors elected by owners
• Committed work force	Ownership and acceptance of responsibilities of ownership
• Product or service with marketplace demand	A work force committed to producing quality (their reputation is at stake)
• Resources (i.e., capital)	Initial investors and potential to raise additional capital after start-up
• Satisfy customer needs	Effective management and committed work force
• Future Potential for growth	Reinvestment of some of the profits

The elements of ownership affecting the individual can be grouped into the five major categories found in Figure 31 below:

FIGURE 31

- active involvement in decisions effecting the work-place;
- equitable sharing in firm's earnings;
- ownership through transfer and acquisition of shares of stock, or ownership position as a percentage of the total;
- input into planning for the future;
- potential to derive benefits from future earnings.

The task force made no attempt to set priorities for these five elements. Each task force member will rank each of the categories differently, depending on their perceptions of variables such as: personality, values, current circumstances, and influence from other sources. Their ranking is, therefore, unimportant to the group decision-making process.

The MDI employee council provided strong evidence to the task force that active involvement in decisions effecting the work-place, took precedent over all other elements, except in August. That was the month during each year when compensation for the next year moves to the number one element. By September, when the new employee's compensation has been put into place, the order reverses again, wherein decisions effecting the work place move back into first position.

What has been most interesting to me is that monetary issues are time sensitive and will be absent for long periods when there is an absence of external agitation. When I personalize this situation, I realize that when I worked on a construction crew I would have gladly exchanged any annual increases for the chance to restructure my job or the job of the crew foreman.

Governance

Because the implementation plan called for employee ownership using the ESOP structure, the task force also needed to consider the structure of organizational governance. How would the Corporation's board of directors and management staff be configured? The set of guidelines found in Figure 32 below were drafted.

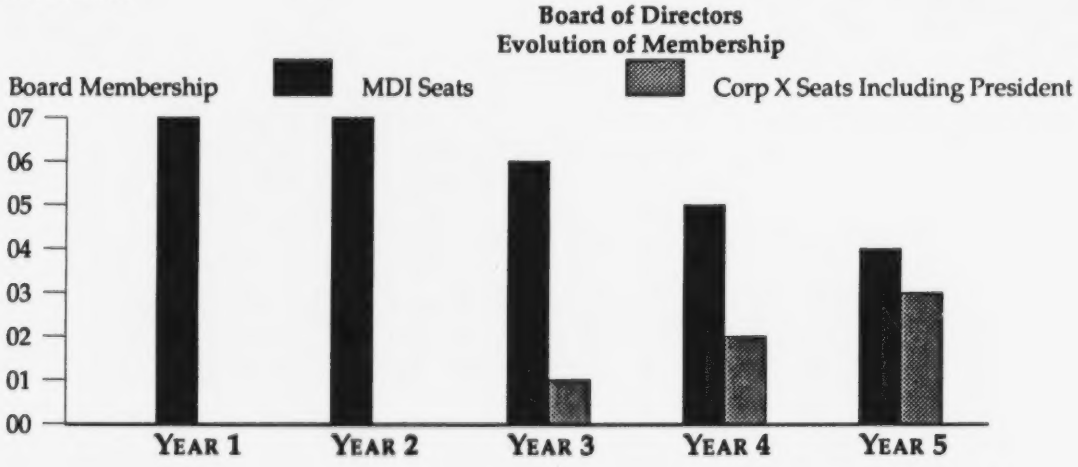
FIGURE 32

- Corporation X will be directed and monitored by a board of directors of no less than three members and no more than seven members.
- All board seats will be appointed for terms of three years with the exception of the first appointments. These appointments will be evenly (so much as possible) divided into thirds, with one-third appointed for three years, one-third appointed for two years, and one-third appointed for one year. (To assure continuity, it is important to minimize the turnover in any given year.)
- Each succeeding year, approximately one-third of the board shall be elected by a vote of the stockholders or their designees.
- The members of the board of Corporation X shall select and appoint a president who will also be a member of the board.
- The president shall select all other employees and determine their compensation within the approved budget.

As the employees of Corporation X acquire stock through either the employee bonus plan or dividend conversion, the selection of the Corporation X board will shift from appointment by MDI's board (the parent corporation's) to election by the stockholders.

It is estimated that after five years of operation the employees of Corporation X could control 49 percent of the outstanding stock. This is the highest percentage of employee ownership allowed at time of incorporation. The parent corporation (MDI) owns the other 51 percent. At this point (after approximately five years or at the time that employee ownership reaches 49 percent of the outstanding stock) the parent corporation, may elect to make available additional stock to Corporation X employees (up to 100 percent) or choose to retain 51 percent until some future time and provide bonus and dividend compensation to employees in some other manner. This is illustrated in Figure 33 below.

FIGURE 33



Administrative Functions

It is essential that all persons engaged in the Corporation X enterprise have a clear understanding and full agreement regarding the role that the board of directors, the management team, and the president play in the operation of the enterprise. In the most basic of terms, the board of directors determines the business in which the corporation will operate and the president will determine how those operations will be carried out. The president's management team works to fulfill the direction provided by the president.

For example, this working relationship was implemented when the board of directors decided that Corporation X should become involved in the rapidly expanding export/import market and assigned the responsibility to develop a plan and budget over to the president and management team. The board, in most instances, reviews the plan and budget on a large project such as this to make sure it is on target with the board's original intent. After this review, the management team would receive its directives from the president to begin implementation of the plan.

Thus, it is essential that the president has membership on the board and is also the leader of the management team. The board of directors, therefore, will elect a chairperson as its leader and will look to the president as a source of information. The board does not look to the president for leadership, unless there is a common position of chairman and president.

I offer little support to any president who complains about a board making bad decisions. Bad decisions are typically based on bad information. Providing useful and appropriate information on a timely basis is the responsibility of the president with the help of the management team. There may be occasions when board decisions may not be in line with the wishes of the president. These, however, are not necessarily bad decisions. They are really only decisions that create interesting challenges.

In some situations poorly trained and/or inexperienced boards will make poor decisions. Again, I hold the board chairperson and president responsible. In cases where inappropriate hiring of board members results in inappropriate decisions, both board members and management should take responsibility for remedying the situation. Both must take the same care in selecting the members of their management teams and board members. A board member with a different philosophical base is no more likely to change than a staff person with an inappropriate philosophical base.

It is important at every board meeting to assure that the agenda is aggressive, but bounded by a budget on time. This demonstrates the value placed on board member time contributions, which may be substantial. If attendance drops off at board meetings, the president and the board chair should quickly meet to identify and remedy the problem. Don't overlook the fact that board members may eventually lose interest in the enterprise and wish to be replaced. They should be thanked for their past efforts and replaced as quickly as possible.

Distribution Of Earnings

The final job of the task force is to develop a process by which Corporation X earnings will be distributed. The guidelines found in Figure 34 below were drafted to govern the distribution of after-tax earnings:

FIGURE 34

1. Every year (after the first year) the board of directors will determine the percentage of after-tax earnings that Corporation X will set aside for a reserve fund. The first year, the percentage to be set into the reserve fund will be 60 percent of after-tax earnings. All remaining after-tax earnings will then be split between two distribution accounts: stock dividends and employee profit sharing.

2. All employees will be subject to a one-year vesting requirement to participate in profit sharing (which may also include stock dividends.) New employees, therefore, will be entitled to a proportional share of profit sharing during the year they complete their twelve month requirement. For example, if an employee starts work six months after start-up, he or she would be eligible at the beginning of the seventh month of the second year (or 1/2 of the second year's profit sharing).

3. Cash dividend distribution will be based on stock ownership, except during the first three years. During the first three years, dividends equaling the difference between actual shares owned by Corporation X employees and the 49 percent made available to them will be applied to the purchase of shares for equal distribution to all vested employees. After the first three years, all dividends will equal stock ownership by MDI or Corporation X employees. During the first year, 10 percent of after-tax earnings will be distributed as stock dividends.

4. During the first year, 30 percent of after-tax earnings will be allocated to employee profit sharing. Because of the first year vesting, that amount will actually carry forward into the second year. The second year, therefore, is the first year when actual profit sharing revenues are distributed to employees.

The formula to be used for the distribution of after-tax earnings involves two computations. First, 50% of the profit sharing dollars are based on equal distribution to all employees. Second, 50% of the profit sharing dollars are distributed on the basis of the person's earnings. The formula to determine the amount of each worker's share is found in Figure 35 below:

FIGURE 35

$$[\,(A/2) / N\,] + [\,(A/2) \times (S/T)\,] = \text{Worker share}$$

N = Number of employees
T = Total payroll
A = Amount available for profit sharing
S = Individual worker salary

For example, a worker making $15,000.00, has completed a full year of vesting and is now eligible to participate in the full amount of profit share revenues. This year total employee compensation was $90,000.00 and after-tax profit was $66,666.67. This combination would make the worker eligible to receive $2,666.67 in profit sharing revenue. The computations are shown in Figure 36 below.

FIGURE 36

IF: After-tax profit is $66,666.67:

$A = 66,666.67 \times 30\% = \$20,000.00$

AND: T = $90,000.00
N = 10 employees
S = $15,000.00

THEN: Using the formula the worker's share is easily calculated:

$$[\,(A/2) / N\,] + [\,(A/2) \times (S/T)\,] = \text{Worker share}$$

$$[(66666.67/2)/10] + [(66666.67/2)\times(15000/90000)] = 2666.67$$

$$[\,(20,000/2) / 10\,] + [\,(20,000/2) \times .167\,] = 2,666.67$$

$$[\,10,000 / 10\,] + [\,10,000 \times .166667\,] = 2,666.67$$

$$1,000 + 1,666.67 = 2,666.67$$

This formula takes into account several factors that will influence the worker's ability to contribute to the total after-tax earnings. They are: 1) Every worker contributes to the success of the enterprise with a substantial amount of effort; and 2) Some workers join the enterprise with substantially more skill than others, ready to accept a greater amount of responsibility or the enterprise will fail.

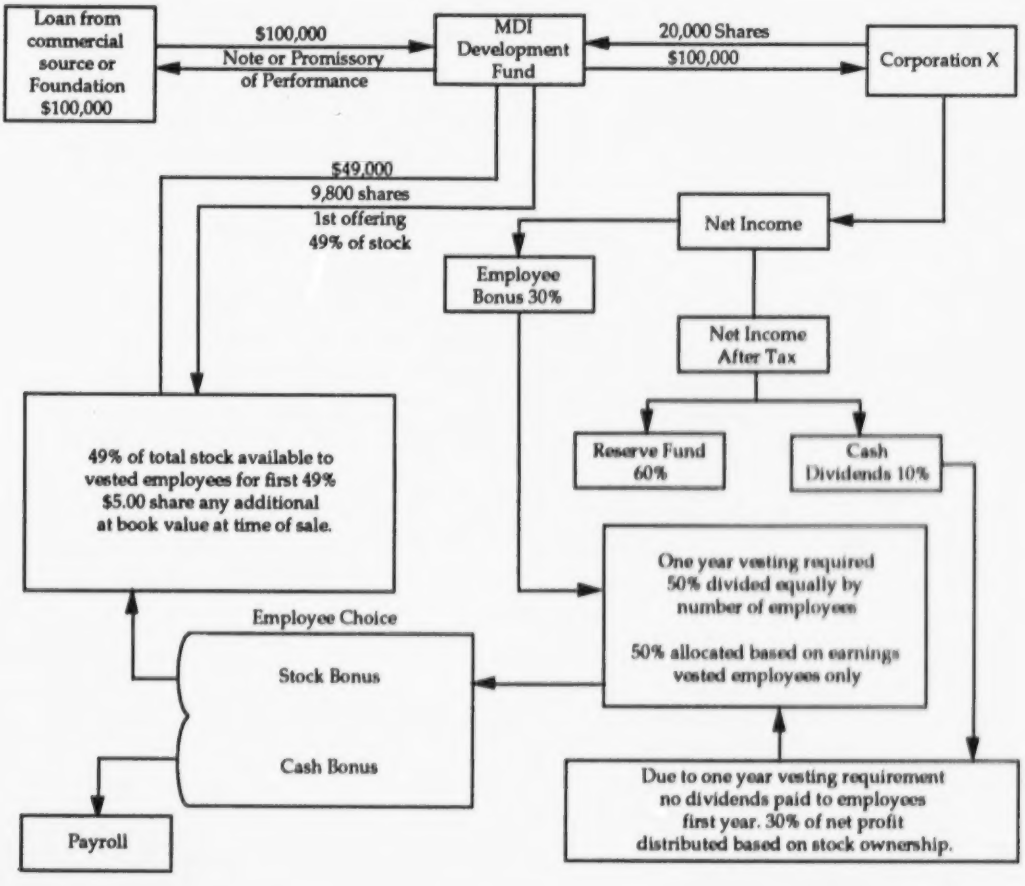
In most payroll systems, management takes several factors into account in setting individual variances in pay rates. These factors include: 1) How well the individual is performing his/her assigned tasks; 2) The skill level that is needed to complete the assigned tasks; 3) The market demand for the skills that are required to complete the assigned tasks; and 4) The length of time the worker has provided skilled services to the enterprise, including the present assignment.

By distributing bonuses on the basis of both group and individual contribution, all of the factors will affect the actual dollars received. Thus, the fifty-fifty bonus split at Corporation X was designed to enhance a sense of "team" membership by rewarding both affiliation and individual effort.

Employee Bonus Plan

Figure 37 below outlines the flow of funds from original investment to profit distribution. As an end goal, the distribution of profits was designed to meet the needs of multiple stake holders. Because Corporation X has designed its business plan around four different segments of the population, the bonus plan must be multidimensional. The four groups are: elderly persons needing supplemental income, workers with handicaps, skilled and experienced model workers, and persons living below the poverty level who have been vocationally disenfranchised.

FIGURE 37


Loan from commercial source or Foundation $100,000
$100,000
Note or Promissory of Performance
MDI Development Fund
20,000 Shares
$100,000
Corporation X
$49,000
9,800 shares
1st offering
49% of stock
Net Income
Employee Bonus 30%
Net Income After Tax
Reserve Fund 60%
Cash Dividends 10%
49% of total stock available to vested employees for first 49% $5.00 share any additional at book value at time of sale.
One year vesting required 50% divided equally by number of employees
50% allocated based on earnings vested employees only
Employee Choice
Stock Bonus
Cash Bonus
Payroll
Due to one year vesting requirement no dividends paid to employees first year. 30% of net profit distributed based on stock ownership.

The split bonus plan, which allows workers to choose between receiving their bonus in the form of cash or Corporation X stock, is the key factor in the plan. Some persons with severe handicaps are limited in the amount of cash earning that they may retain. Outdated regulations that reduce their overall income from all sources when their earnings increase due to improved performance on the job penalize productive work. In some cases the adage: "The harder I work, the further behind I get" may, in fact, be true.

The split bonus option may help persons in this situation by allowing them to participate on the stock side of the plan. Because only phantom stock is issued, with no public cash value, it cannot be sold and therefore may not be considered income. The employee must hold their stock to termination or retirement. Only then does the stock have value, and only through the employee's sale of the stock back to Corporation X. If the amount is large, some workers may choose to go off of public assistance until they have spent the funds received in the sale. Many, for the first time in their life, could enjoy ownership without jeopardizing the loss of welfare assistance. Some of these workers might need medical assistance that is not covered by the company-sponsored medical insurance program. Their right to assistance must be protected and not jeopardized by increased earnings.

Older workers needing or desiring supplemental income are more likely to choose the cash bonus though many still want to have ownership in the Corporation. They are usually at an age when storing stock is not a good working strategy. The bonus plan, however, may still help them develop a commitment to the enterprise and provide them with cash as well. They may choose to become an employee-owner with at least a small portion of their bonus income converted to stock with the rest provided as cash compensation.

Poor workers have an over-riding demand for cash that may force them to take most, if not all, of their bonuses as cash. The cash may be needed to purchase life's essentials. Over time, however, it is expected that steady income will allow them to also participate in the stock option. They may develop an understanding of deferred compensation and its rewards.

Model or skilled workers are the primary target for the stock option side of the bonus plan. Many workers may choose to work for Corporation X for many years. These workers are likely to opt for ownership to participate in management decisions that will affect their employment, positively influencing decisions that may lead to relocation or plant closing.

Although in Figure 37 the net profit after taxes is split sixty-forty (i.e., 60 percent for reinvestment and 40 percent distribution to employee bonuses and dividends to the owners), there are circumstances where the reverse is appropriate. There is nothing special about the distribution percentages used in this example. However, it is important that everyone involved recognize the need to reinvest some of the Corporation's earnings. There will not be a fund-drive every five or ten years to obtain required capital funds. These funds must be created by reinvestment of profits over time.

Financing Corporation X

The original financing plan for Corporation X was designed to take advantage of a growing interest among foundations in the use of Project Related Investment (PRI) funds. This is the foundation industry's equivalent to a venture capital loan. This method of financing was selected for three reasons. First, a foundation would only require that the venture be successful and accomplish its goals. Second, a foundation would expect repayment equal the original loan principal without interest (or at a token interest of three to four percent.) Third, although the business plan was strong enough to obtain financing from a venture capital fund, these funds would require a prohibitively high return for the investment, lessening the possibility that workers would be able to participate in substantial bonus and profit-sharing plans early in the Corporation's history.

After several meetings with foundation officials, and a careful study of their requests for project modifications, the board decided that MDI would borrow the required funds through a commercial lending source and maintain full ownership and control as long as possible. The board's concern with using foundation loans was the loss of control inherent in accepting the use of their dollars.

To be assured that at some future date the majority interest could be transferred to the employees of Corporation X, the board felt that it needed to retain the amount of control provided by the use of commercial funds. This may really have been short-sighted. If control is maintained at the expense of under-capitalization, the venture will also fail to meet its objectives, and the employees could lose everything. However, the following plan was chosen.

The first year carry forward of profit sharing for non-vested employees will be used as working capital by the new enterprise. During the start of the critical second year, Corporation X could have available up to $38,115 of additional working capital that may help reduce the need for borrowing and add up to an addition $3,000 to $4,000 of profits from interest savings to be distributed to the employees of the enterprise. Figure 38 below outlines the financing plan adopted by the board.

FIGURE 38

Operating capital $100,000
MDI receives 20,000 shares of stock

Income		$560,000
Expense		500,000
Net before tax	$ 60,000	
Taxes		15,000
Available for distribution	$ 45,000	

With a 40-60 split:
Reserve fund 40% x $45,000 = $18,000
Profit sharing 30% x $45,000 = $13,500
Dividends 30% x $45,000 = $13,500

No employee pay out—first year vesting required

MDI received 51% x $13,500 = $6,885 dividends
Corporation X employee stock fund 49% x $13,500 = $6,615
Profit sharing carry over to second year $13,500

Second year addition to working capital:	
Employee stock fund	$ 6,615
Reserve fund set aside	18,000
Profit sharing carry forward to second year (one year vesting required)	13,500
Additional working capital	$38,115

This financing plan illustrates one of the true benefits of employee ownership. Workers multiply their income by reinvesting in themselves. There is a risk of loss by reinvesting these funds. That risk must be carefully considered. But most workers choose to gamble on themselves and their coworkers over any of the other groups of individuals.

Chapter Five

Applying Basic Human Principles to Entrepreneurial Enterprises

Corporate Accountability

Because Corporation X is a for-profit enterprise, management must maintain a constant effort to remain profitable. Without profit, the Corporation will soon dissolve. To remain profitable while, at the same time, being a good corporate citizen is the struggle every business enterprise engages in day in and day out.

Corporation X was designed to demonstrate its corporate responsibility through its exceptional efforts to provide employment opportunities for persons with employment-related handicaps. Before the importance of that statement can really be under- stood, some basic principles should be discussed. They are the principles of responsibility, opportunity, and dignity of risk. What follows is a portion of a previously published book, The Affirmative Industry, in which these principles are examined.

Responsibility

The responsibility for growth and achievement, for happiness, lies fundamentally with each individual. The decision to progress can only come from within. It is impossible for one individual to assume direct responsibility for the growth of another. Each person must assume that responsibility.

To a great extent, however, an individual's growth is interrelated with the growth of others. As the most fundamental unit of society, the aggregate behaviors of all individuals directly determine the quality of life for the entire society. Each individual who finds success and happiness through progressive achievement improves the quality of life for the entire society and thereby improves, to some degree great or small, the quality of life of every member in that society. Along the same lines, if every individual's achievement becomes everyone's achievement, then also every individual's limitation is, in truth, everyone's limitation.

Our own progress, therefore, is not only dependent upon our own achievements, but also upon the successes achieved by others. To fulfill our responsibility to ourselves for our own progress, we must, by association, become responsible for ensuring that the opportunity for progress is provided to all members of society. By providing the opportunity for growth to others, we automatically provide the greatest opportunity for growth ourselves. By ensuring that each member of society has the greatest opportunity for achievement, maximum progress is afforded to all.

Opportunity

Franklin D. Roosevelt said, "Liberty requires opportunity to make a living—a living which gives man not only enough to live by, but something to live for."

Opportunity is the mother of life; it nurtures all expansion, development, and growth. Each moment of life, each new situation, brings a chance for new life, for personal expansion. The gift of opportunity is the most precious of all gifts, since all we can ever really give in our attempt to help another is the gift of opportunity. In fact, to give anything more that opportunity is to give something less.

Each of us has limitations—some have more, other less. We can view each of these limitations as either a restriction to further progress, a contradiction to life, or as a unique opportunity for greater growth and achievement—a seed for new life. What greater joy, or achievement, is found than to overcome that which has previously restricted our progress

and limited our life? We need only realize that problems and limitations cease to be problems and limitations when they are used as opportunities for progress; opportunities that may be seized for some new expression of our unique existence.

Dignity of risk

Opportunities for growth, as described above, carry with them by definition the possibility of failure. Accompanying every endeavor is the element of risk. If growth truly implies change for improvement, then it must also carry with it the chance that there will be no change, no improvement, or even failure. When a person's environment is overprotected in such a manner that there is little or no chance for real or significant success, he/she has really been given no opportunity for growth. To deprive someone of the opportunity for significant achievement because of an associated element of risk is to deprive that person of the potential for growth toward a self-sufficient, progressive, and dignified state of life.

The goal of providing employment opportunities for individuals with employment-related handicaps will not be achieved unless there is positive support from all the employees. This support will not be gained unless there is a common understanding by each of the four worker groups at Corporation X. Each group begins working at Corporation X with very specific preconceived ideas which must be dealt with before any meaningful team building may take place.

Perceptions/Expectations

Our expectations of an individual, of his or her ability to grow and progress, are directly related to how we perceive that individual. If we perceive an individual as helpless and dependent, then we will, of course, expect only helpless and dependent behavior from that individual. These limited expectations encourage us to place that person in highly structured 'protected' environments. As a result, this individual becomes unknowingly caught up in a vicious, self-perpetuating cycle of dependency and inadequacy.

It is, of course, just as inappropriate to expect the impossible, to ask persons who are handicapped to function effectively and successfully in an environment which demands a type or level of performance which is physically impossible for them. These individuals only become over-burdened and the inevitable occurs—a self- destructive sense of failure and defeat. Dependency is reinforced and, therefore, increased.

In order to break this cycle, we need to provide persons who are handicapped with an environment where the stimuli and opportunities for growth and expansion are matched with each individual's abilities and potential for progress. An effective means for structuring such an enlivening, challenging, yet individually appropriate environment is simply to focus our attention and subsequently our efforts on the positive or potentially progressive aspects of the individual's life. It is not necessary to deny the existence of any of the limitations that an individual may possess; we simply emphasize the positive, growth-producing qualities. Upon whatever we choose to focus our attention, that is most likely to become pronounced or to develop. If we focus our attention on an individual's limitations, our evaluations and subsequent expectations of that individual will be limited. These limited perceptions will naturally affect our interactions with that individual and will, to a considerable extent, dictate how we attempt to structure that individual's environment. The outcome for that person will obviously be an increased sense of inadequacy leading to increased dependency.

If, however, we focus our attention on the individual's positive characteristics and assets, if we emphasize the capacity for growth and creative expression, we will interact spontaneously and naturally with that individual in a manner which nurtures those abilities and capacities, maximizing their abilities. Our expectations will prove to be life-supporting and humanizing, resulting both in positive, growth-producing interaction and in the maintenance of an environment which provides the individual with an appropriate amount of stimulation and challenge.

Our perceptions dictate our expectations, which in turn influence our interaction. Providing successful, life—supporting conditions is simply a matter of expanding our perceptions.

Valued Activity

If persons who are devalued are to be recognized as contributing members of society, the activities in which they are involved must be activities that are valued by that society. If these individuals are to break the debilitating stigma under which they have been forced to live, a stigma of incompetence and dependency, then they must be involved in competent and socially recognizable activity.

Two major factors which society uses in evaluating the importance or value of an activity are 1) the activity itself, whether or not that activity is perceived as contributing to the quality of life in that society and 2) the context within which the activity is being performed. To break the stigma of incompetence, these individuals must be provided with both the opportunity for meaningful, productive activity and with a value-appropriate facility within which to perform that activity.

Risk Management and the Entrepreneur

Most of us have a perception of entrepreneurs as "barn stormers" living on the verge of disaster; or perhaps we see them as magical individuals who have an ability to always land on their feet like a cat. I do agree that they have a special survivability, but it is planned and rarely left to chance. A more reflective example would be test pilots who live daily with a certain element of risk, but who fly unproven planes because they are skilled fliers.

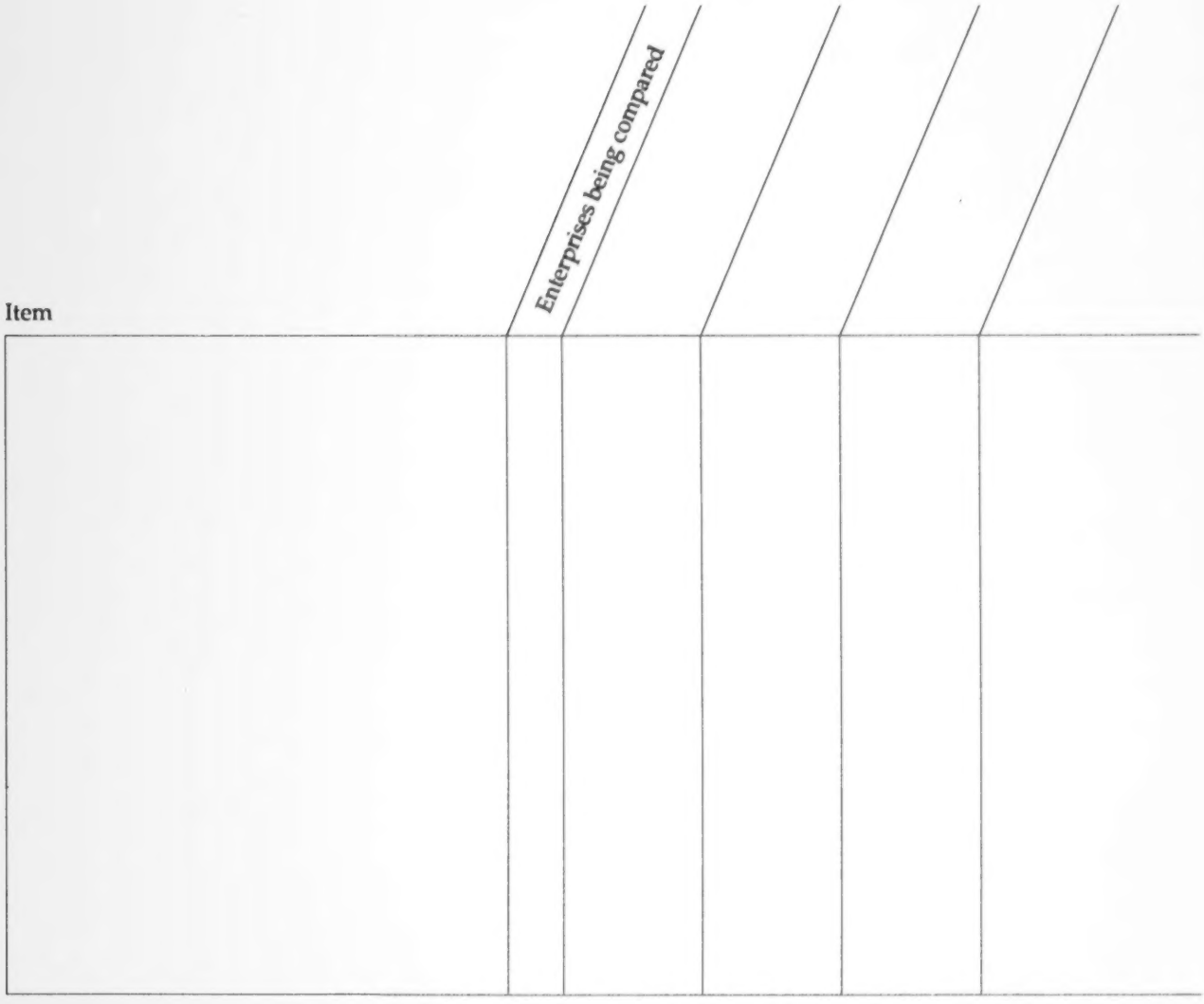
The two basic elements of the entrepreneurial manager are the skills that the individual has and the entrepreneur's confidence in those skills. The second element is exemplified by the fact that test pilots take up unproven planes, not necessarily planes with an excessive crash rate.

When that test pilot takes off in the test plane, all available options to be used in the event of a malfunction have been considered. The pilot is ready to execute the most appropriate option as soon as its execution is warranted. These options could range from quick radio contact with ground-based experts to emergency landings at pre-determined places. Of course, they also include a reaction to the most severe situation requiring a bail out, allowing the aircraft to crash.

Successful entrepreneurs never enter a situation without believing in their own survivability. However, they will accept a number of optional outcomes. It is this very ability to accept multiple outcomes that is responsible for the entrepreneur's undeserved reputation as an opportunist. If selecting the option that is most likely to reach a point with an acceptable range of the goal is opportunistic, then most entrepreneurs are truly opportunistic. This decision-making strategy should not be perceived as unprincipled but as a valid interpretation of the tasks required to operate within the parameters of a successful entrepreneurial system.

APPENDIX A

VALUE/DEMAND CHART



High = High M = Medium L = Low
First letter is for value
Second letter is for demand
Example: L-M Low Value, Medium Demand
H-L High Value, Low Demand

APPENDIX B

SELECTION ISSUES CHART

Issues Considered in Model Selection	Advantages		Modification Possible
Financial	F.P.	N.F.P.	
1.			
2.			
3.			
4.			
5.			
6.			
7.			
8.			
9.			
Governance			
10.			
11.			
12.			
13.			
14.			
15.			
16.			
Social			
17.			
18.			
19.			
20.			
Other			
21.			
22.			
23.			
24.			

APPENDIX C

STAKEHOLDER INPUT/RESPONSIBILITY CHART

Stakeholder	Interest	Responsibility	Potential Input	Responsibility to them

APPENDIX D

IMPLEMENTATION PLANNING SHEET

Activity	Primary Assigned Responsibility	Secondary or technical back-up	Start Date	Completion Date

APPENDIX E

NEEDS ASSESSMENT WORKSHEET

Individual needs	Method of providing	Evaluation

Enterprise needs	Method of providing	Evaluation

APPENDIX E CONTINUED

NEEDS ASSESSMENT WORKSHEET

Community needs	Method of providing	Evaluation

Other needs	Method of providing	Evaluation